TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1936

No. 24

ALGERNON S. SCHAFER, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 25

EDWARD SCHAFER, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 26

LEONARD SCHAFER, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

PETITION FOR CERTIORARI FILED APRIL 6, 1936.

CERTIORARI GRANTED MAY 18, 1936.

SUPREME COURT OF THE UNITED STATES

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[fol. 1] [Caption omitted]

BEFORE U. S. BOARD OF TAX APPEALS

Docket No. 72370

ALGERNON S. SCHAFER, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appearances:

For Petitioner: Eugene Untermyer, Esq.
For respondent: R. W. Wilson, Esq.

DOCKET ENTRIES

1933.

May 20. Petition received and filed. Taxpayer notified (Fee paid.)
May 20. Copy of petition served on General Counsel.
May 29. Notice of appearance of Eugene Untermyer as counsel filed.
July 1. Answer filed by General Counsel.
July 13. Copy of answer served on taxpayer.
Sept. 18. Order placing proceeding on Circuit Calendar for hearing in New York City entered.

1934.

Jan. 2. Hearing set for week of 2/5/34, New York, N. Y.
Feb. 28. Hearing had before Mr. Leech, Division 6, on merits. Consolidated with 72373-74. Stipulation of facts filed. Petitioner's brief due 3/30/34—reply 4/25/34. Commissioner's brief due 4/15/34.

[fol. 2]

Mar. 13. Transcript of hearing 2/28/34 filed.
Mar. 29. Brief filed by taxpayer 3/30/34 copy served.
Apr 16. Brief filed by General Counsel.
Apr. 21. Reply brief filed by taxpayer. 4/23/34 copy served.

1935.

Mar. 28. Findings of fact and opinion rendered—J. R. Leech, Division 6. Decision will be entered for respondent.

1935.

Mar. 30. Decision entered—Division 15, Eugene Black.
June 21. Stipulation for review by the Court of Appeals for the District of Columbia filed.
June 21. Petition for review by U. S. Court of Appeals for the District of Columbia with assignments of error filed by taxpayer.
June 21. Proof of service filed by taxpayer.
Aug. 6. Agreed statement of evidence lodged.
Aug. 6. Agreed præcipe filed.
Aug. 7. Agreed statement of evidence approved and ordered filed.
Aug. 20. Order enlarging time to Sept. 23, 1935 for transmission and delivery of record entered.

BEFORE U. S. BOARD OF TAX APPEALS

Docket No. 72373

EDWARD SCHÄFER, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appearances:

For Petitioner: Eugene Untermyer, Esq.
For Respondent: R. W. Wilson, Esq.

DOCKET ENTRIES

1933.

May 20. Petition received and filed. Taxpayer notified. (Fee paid.)
May 20. Copy of petition served on General Counsel.
May 29. Notice of appearance of Eugene Untermyer as counsel filed.
July 1. Answer filed by General Counsel.
July 13. Copy of answer served on taxpayer.

[fol. 3]

Sept. 18. Order placing proceeding on Circuit Calendar for hearing in New York City entered.

DOCKET ENTRIES—Continued

1934.

Jan. 2. Hearing set 2/5/34, New York, N. Y.

Feb. 28. Hearing had before Mr. Leech, Division 6, on merits. Consolidated with 72370-74. Stipulation of facts filed. Petitioner's brief due 3/30/34—reply 4/25/34—Commissioner's brief 4/15/34.

Mar. 13. Transcript of hearing 2/28/34 filed.

Mar. 29. Brief filed by taxpayer. 3/30/34 copy served.

Apr. 16. Brief filed by General Counsel.

Apr. 21. Reply brief filed by taxpayer. 4/23/34 copy served.

1935.

Mar. 28. Findings of fact and opinion rendered—J. R. Leech, Division 6. Decision will be entered for respondent.

Mar. 30. Decision entered—Division 15, Eugene Black.

June 21. Stipulation for review by Court of Appeals for the District of Columbia filed.

June 21. Petition for review by U. S. Court of Appeals for the District of Columbia with assignments of error filed by taxpayer.

June 21. Proof of service filed by taxpayer.

Aug. 6. Agreed statement of evidence lodged.

Aug. 6. Agreed præcipe filed.

Aug. 7. Agreed statement of evidence approved and ordered filed.

Aug. 20. Order enlarging time to Sept. 23, 1935 for transmission and delivery of record entered.

BEFORE U. S. BOARD OF TAX APPEALS

Docket No. 72374

LEONARD SCHAFER, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appearances:

For Petitioner: Eugene Untermyer, Esq.;
For Respondent: R. W. Wilson, Esq.

[fol. 4] DOCKET ENTRIES

1933.

May 20. Petition received and filed. Taxpayer notified. (Fee paid.)
May 20. Copy of petition served on General Counsel.
May 29. Notice of appearance of Eugene Untermyer as counsel filed.
July 1. Answer filed by General Counsel.
July 13. Copy of answer served on taxpayer.
Sept. 18. Order placing proceeding on Circuit Calendar for hearing in New York City entered.

1934.

Jan. 2. Hearing set for week of 2/5/34, New York, N. Y.
Feb. 28. Hearing had before Mr. Leech, Division 6, on merits. Consolidated with 72370-73. Stipulation of facts filed. Petitioner's brief due 3/30/34—reply 4/25/34—Commissioner's brief 4/15/34.
Mar. 13. Transcript of hearing 2/28/34 filed.
Mar. 29. Brief filed by taxpayer. 3/30/34 copy served.
Apr. 16. Brief filed by General Counsel.
Apr. 21. Reply brief filed by taxpayer. 4/23/34 copy served.

1935.

Mar. 28. Findings of fact and opinion rendered—J. R. Leech, Division 6. Decision will be entered for respondent.
Mar. 30. Decision entered—Division 15, Eugene Black.
June 21. Stipulation for review by Court of Appeals for the District of Columbia filed.

DOCKET ENTRIES—Continued

1935.

June 21. Petition for review by U. S. Court of Appeals for the District of Columbia with assignments of error filed by taxpayer.

June 21. Proof of service filed by taxpayer.

Aug. 6. Agreed statement of evidence lodged.

Aug. 6. Agreed præcipe filed.

Aug. 7. Agreed statement of evidence approved and ordered filed.

Aug. 20. Order enlarging time to Sept. 23, 1935 for transmission and delivery of record entered.

[fol. 5] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 72370

[Title omitted]

PETITION—Filed May 20, 1933

Algernon S. Schafer, the above-named petitioner, hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency for the calendar year 1929 dated March 21, 1933, and initialled IT: AR: A-1 JBW-60D, and as a basis for this proceeding alleges as follows:

I. Your petitioner is an individual, and his post office address is No. One Wall Street, Borough of Manhattan, City of New York, N. Y.

II. The notice of deficiency, a copy of which is hereto attached and marked Exhibit A, was mailed to your petitioner under date of March 21, 1933.

III. The tax in dispute is income tax for the calendar year 1929 and is in the amount of $33,329.20.

IV. The determination of the tax set forth in said notice of deficiency is based on the following errors.

1. The disallowance of inventories of securities by the partnership of Schafer Bros. at market as of the beginning and end of the taxable year, the restoring of the value of

such securities to alleged cost, and the consequent increase of income of the partnership alleged to be subject to income tax for the calendar year 1929 in the amount of $511,667.

2. The disallowance as a deduction from the income of the partnership of Schafer Bros. subject to tax of bad debts aggregating $2500;

3. The consequent increase of income of your petitioner alleged to be subject to income tax for the calendar year 1929 in the amount of $171,867.52.

[fol. 6] V. The facts upon which the petitioner relies as a basis for this proceeding are as follows:

A. As respects the inventorying of securities:

1. The copartnership of Schafer Bros. from in or about the year 1918 up to February 1, 1932, consisted of the three brothers, Leonard Schafer, Algernon S. Schafer (your petitioner herein) and Edward Schafer, all of whom were general partners. The original firm was founded by the father of the said partners in the year 1860 and said firm, as from time to time constituted, was at all times since its formation doing business in the City of New York.

2. Said firm was and at all times hereinbefore mentioned had been since about the year 1865 a member of the New York Stock Exchange. Since its formation it had conducted a general business as dealer and merchant in securities on commission and on margin, including as an essential part of its business the dealing in securities for the account of the partnership, and had at all times a suite of offices and an established place of business in the City of New York.

3. Since the year 1899 Leonard Schafer aforesaid had owned a seat on the New York Stock Exchange and at all times since the aforesaid partnership was formed in 1918 and up to February 1, 1932, said Leonard Schafer had been the floor member of the partnership, and the two remaining partners had been its office members and both actively engaged in the conduct of its business.

4. As an essential part of its business said partnership engaged in the business of a dealer and merchant in securities by dealing therein for its own account, in most part

through its own floor member, Leonard Schafer, and at other times through other brokers. This branch of its business was conducted under numerous separate accounts that appear on its books, including an account entitled "Error Account." Transactions effected in such accounts, including the Error Account aforesaid, were for the purpose and with the expectation of realizing a profit thereon within the immediate future as a dealer in securities by their rapid turnover, and none of said securities were acquired for investment purposes or with the expectation of holding the same as investments.

5. When it was desired to acquire securities for investment the same was not effected through the partnership [fol. 7] but for the account of the individual partners, and such securities were either withdrawn by them or credited to their separate capital accounts upon the books of the firm.

6. From time to time securities dealt in in the Error Account and other trading accounts, upon which the partnership anticipated the realization of profit at the time of acquisition, did not increase but diminished in value, in which event it became necessary, to carry out the purpose of the transaction, for the partnership to retain such securities for a period of time unanticipated at the time of their acquisition and wholly undesired, but always with the intention that said securities would be disposed of when an adequate price therefor could be obtained.

7. During the year 1929 the partnership, in the general course of its business, engaged in extensive trading operations in its various trading accounts, including the Error Account. Of the 16,738 shares on hand and inventoried at the beginning of the year 1929, 9,800 shares were sold during said calendar year. In the Error Account alone the partnership in 1929 traded in upwards of 72 different items or varieties of securities, purchased an aggregate of 107,500 shares of stock of such various securities and sold 92,500 shares thereof in the Error Account. The profits anticipated were adversely affected by the sharp decline in values on the New York Stock Exchange that occurred in the autumn of 1929, so that at the end of said year a number of securities remained in the Error Account for the reason

that the partnership had been unable to dispose thereof at prices deemed adequate during the course of such year.

8. All of the securities remaining in the Error Account on December 31, 1929, with the exception of 500 shares of New York Transportation Co. and 38 shares of Tidal Osage Oil, were disposed of by the partnership during the calendar year 1930, long prior to the time that said partnership or any member thereof had any intimation of the position the Government would endeavor to assert with respect to the issue in controversy herein.

9. In each and every year since in or about 1921 and up to February 1, 1932, said partnership had adopted a uniform practice of inventorying the securities in the Error Account and in the other trading accounts at their market values as of the end of each calendar month. This practice [fol. 8] was essential in a business of the nature conducted by the partnership. The firm would not have been able to comprehend its true financial position in a business of such fluctuating values as if it had relied upon cost, and the nature of its business compelled the frequent taking of inventories evidencing the true value of securities held, in order to enable the partners to appreciate where they stood and as a basis of the credit of the partnership. Such credit was essential to its business.

10. The partnership had at all times, since it adopted the practice of inventorying securities, consistently reflected such practice with respect to the Error Account and its other accounts in its tax reurns, and for the previous ten years income taxes upon its income (which was frequently enhanced by reason of the practice of inventorying securities above cost) were paid by the partners upon their distributive share of the profits so determined without any protest by the Government or any intimation that such method of inventorying the securities was improper or contrary to law.

11. The values at which the securities in said Error Account and the other trading accounts of the partnership were inventoried as of December 31, 1928 and December 31, 1929 were determined by the condition of the market for such securities as of said dates at the fair market values thereof, after full investigation and careful consideration by the members of said partnership. All of the securities so

held in the trading accounts, including the Error Account, were acquired for the purpose of realizing a profit upon the ultimate sale thereof in the course of the partnership's business as a dealer in securities, and none of said securities were held for the purpose of investment.

B. As respects the item of bad debts.

1. Your petitioner claims a proportionate deduction from his income subject to tax for bad debts of the partnership of Schafer Bros. aggregating $2500, for the following advances:

To one Harold Seeman	$1,000.00
To one Emil Kolb	1,000.00
And to one Reisman	500.00

These advances were all made by Edward Schafer, for the account of the partnership in the course of its business [fol. 9] and were all ascertained to be worthless and uncollectable in the year 1929.

Wherefore your petitioner prays that this Board may hear this appeal and redetermine what, if any, amount your petitioner is legally liable for as deficiency tax for the year 1929, the petitioner, however, insisting and claiming that he is not liable for any deficiency tax for said period, exceeding such additional amount of tax as may be due in respect to the amounts specified in paragraphs numbered "2" and "3" contained in the deficiency letter hereto annexed.

Your petitioner hereby designates as his post office address to which notices in this proceeding be sent as Algernon S. Schafer, care of Eugene Untermyer, No. 30 Pine Street, New York City, N. Y.

Dated, New York, May 17, 1933.

Algernon S. Schafer. Eugene Untermyer, Attorney for Petitioner, 30 Pine Street, New York City, N. Y.

Duly sworn to by Algernon S. Schafer. Jurat omitted in printing.

[fol. 10] EXHIBIT "A" TO PETITION

Treasury Department, Washington

Office of Commissioner of Internal Revenue

Mar. 21, 1933.

Mr. Algernon S. Schafer, 120 Broadway, New York, New York.

SIR:

You are advised that the determination of your tax liability for the year 1929 disclosed a deficiency of $33,329.20 as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, if you do not desire to petition, you are requested to execute the inclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this form will expedite the closing of your return(s) by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the inclosed form, or on the date assessment is made, whichever is earlier; Whereas if this form is not filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully, David Burnet, Commissioner, by W. T. Sherwood, Acting Deputy Commissioner.

Inclosures: Statement. Form 870.

[fol. 11] Statement

IT:AR:A-1.
JBW-60D.

In re Mr. Algernon S. Schafer, 120 Broadway, New York, New York

Year	Income Tax Liability	Income Tax Assessed	Deficiency
1929	$35,391.38	$2,062.18	$33,329.20

The deficiency shown herein is based upon the report dated June 30, 1931 prepared by Internal Revenue Agent John J. Crowley, Jr., and transmitted to you under date of August 4, 1931, which report is made a part of this letter.

Careful consideration has been accorded your protest dated October 13, 1931, in connection with the findings of the examining officer, and the information submitted at conferences held in the office of the internal revenue agent in charge under date of November 4, 1931 and in this office under date of November 16, 1932.

The adjustments made and computation of tax follow:

Net income as shown on the return		$38,040.21
Plus.		
1. Partnership income increased	$171,867.52	
2. Loss from estate disallowed	991.95	
3. Additional profit on sale of securities	1,920.84	
		174,780.31
Net income adjusted		$212,820.52

Explanation of Changes

1. Income received from partnership of Schafer Brothers increased due to disallowing inventory to the partnership at "cost or market whichever is lower" in accordance with G. C. M. 9656—IT:Rev. Bulletin X-33.

2. Loss from Estate of S. M. Schafer represents a loss covering operating and upkeep expenses of property held [fol. 12] in estate properly chargeable to the corpus. It is, therefore, disallowed.

3. Profit on sales of securities increased due to your having computed profit on a joint account by inventorying at "cost or market whichever is lower", which is not allowable. The additional profit is based on cost and is determined as follows:

E. S. #2 Account—⅓ Interest

Inventory of securities at end of year—cost	$159,762.50
Inventory of securities at end of year—claimed	154,000.00
Excess of cost over market	$5,762.50
Your one-third interest	$1,920.84

NOTE.—Profit on securities sold which were held more than two years has been transferred to capital net gain in the amount of $51,609.40.

Consent which will expire on June 30, 1934, except as extended by the provisions of section 277 of the Revenue Act of 1928, is on file for the year 1929.

Computation of Tax

Total net income adjusted		$212,820.52
Less:		
Capital net gain included		51,609.40
Ordinary net income adjusted		$161,211.12
Less:		
Dividends	$17,151.59	
Personal exemption and credit for dependents	3,900.00	
		21,051.59
Net income subject to normal tax		$140,159.53
Normal tax at ½% on $4,000.00		$20.00
Normal tax at 2% on $4,000.00		80.00
Normal tax at 4% on $132,159.53		5,286.38
Surtax on $161,211.12		23,902.22
Tax at 12½% on capital net gain of $51,609.40		6,451.18
Total		$35,739.78

[fol. 13]

Brought forward	$35,739.78
Less:	
Earned income credit on $27,359.95	348.40
Income tax liability	$35,391.38
Income tax previously assessed, account #311593	2,062.18
Deficiency in tax	$33,329.20

[File endorsement omitted.]

BEFORE UNITED STATES BOARD OF TAX APPEALS

No. 72370

[Title omitted]

ANSWER—Filed July 1, 1933

Comes now the respondent by his attorney, E Barrett Prettyman, General Counsel, Bureau of Internal Revenue, and in answer to the petition of the petitioner, admits, denies and alleges as follows:

I, II and III. Admits the allegations contained in paragraphs one, two and three of the petition.

IV. (1), (2) and (3) Denies that the respondent committed errors as alleged in sub-paragraphs (1), (2) and (3) of paragraph four of the petition.

V. (1), (2) and (3) Admits the allegations contained in sub-paragraphs (1), (2) and (3) of paragraph five of the petition.

V. (4) to (11) inc. Has insufficient information to form a belief as to the allegations contained in sub-paragraphs (4) to (11) inc. of paragraph five of the petition, and hence denies the same.

[fol. 14] V. (B) (1) Denies the allegations contained in sub-paragraph (B) (1) of paragraph five of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified or denied.

Wherefore, it is prayed that the petitioner's appeal be denied and the Commissioner's determination of deficiency be approved.

(Signed) E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue. DeWitt M. Evans, Special Attorney, Bureau of Internal Revenue, Of Counsel.

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 72373

[Title omitted]

PETITION—Filed May 20, 1933

Edward Schafer, the above-named petitioner, hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency for the calendar year 1929, dated March 21, 1933, and initialed IT:AR:A-1 JBW-60D, and as a basis for this proceeding alleges as follows:

I. Your petitioner is an individual, and his post office address is No. One Wall Street, Borough of Manhattan, City of New York, N. Y.

II. The notice of deficiency, a copy of which is hereto attached and marked Exhibit A, was mailed to your petitioner under date of March 21, 1933.

III. The tax in dispute is income tax for the calendar year 1929 and is in the amount of $33,423.09.

IV. The determination of the tax set forth in said notice of deficiency is based on the following errors.

[fol. 15] 1. The disallowance of inventories of securities by the partnership of Schafer Bros. at market as of the beginning and end of the taxable year, the restoring of the value of such securities to alleged cost, and the consequent increase of income of the partnership alleged to be subject to income tax for the calendar year 1929 in the amount of $511,667.

2. The disallowance as a deduction from the income of the partnership of Schafer Bros. subject to tax of bad debts aggregating $2,500;

3. The consequent increase of income of your petitioner alleged to be subject to income tax for the calendar year 1929 in the amount of $175,297.28.

V. The facts upon which the petitioner relies as a basis for this proceeding are as follows:

A. As respects the inventorying of securities:

1. The copartnership of Schafer Bros. from in or about the year 1918 up to February 1, 1932, consisted of the three brothers, Leonard Schafer, Edward Schafer (your petitioner herein) and Algernon S. Schafer, all of whom were general partners. The original firm was founded by the father of the said partners in the year 1860 and said firm, as from time to time constituted, was at all times since its formation doing business in the City of New York.

2. Said firm was and at all times hereinbefore mentioned had been since about the year 1865 a member of the New York Stock Exchange. Since its formation it had conducted a general business as dealer and merchant in securities on commission and on margin, including as an essential part of its business the dealing in securities for the account of the partnership, and had at all times a suite of offices and an established place of business in the City of New York.

3. Since the year 1899 Leonard Schafer aforesaid had owned a seat on the New York Stock Exchange and at all times since the aforesaid partnership was formed in 1918 and up to February 1, 1932, said Leonard Schafer had been the floor member of the partnership, and the two remaining partners had been its office members and both actively engaged in the conduct of its business.

4. As an essential part of its business said partnership engaged in the business of a dealer and merchant in securi- [fol. 16] ties by dealing therein for its own account, in most part through its own floor member, Leonard Schafer, and at other times through other brokers. This branch of its business was conducted under numerous separate accounts that appear on its books, including an account entitled "Error Account". Transactions effected in such accounts, including the Error Account aforesaid were for the purpose and with the expectation of realizing a profit thereon within the immediate future as a dealer in securities by their rapid turnover, and none of said securities were acquired for investment purposes or with the expectation of holding the same as investments.

5. When it was desired to acquire securities for investment the same was not effected through the partnership but for the account of the individual partners, and such securities were either withdrawn by them or credited to their separate capital accounts upon the books of the firm.

6. From time to time securities dealt in in the Error Account and other trading accounts, upon which the partnership anticipated the realization of profit at the time of acquisition, did not incease but diminished in value, in which event it became necessary, to carry out the purpose of the transaction, for the partnership to retain such securities for a period of time unanticipated at the time of their acquisition and wholly undesired, but always with the intention that said securities would be disposed of when an adequate price therefor could be obtained.

7. During the year 1929 the partnership, in the general course of its business, engaged in extensive trading operations in its various trading accounts, including the Error Account. Of the 16,738 shares on hand and inventoried at the beginning of the year 1929, 9,800 shares were sold during said calendar year. In the Error Account alone the partnership in 1929 traded in upwards of 72 different items or varieties of securities, purchased an aggregate of 107,500 shares of stock of such various securities and sold 92,500 shares thereof in the Error Account. The profits anticipated were adversely affected by the sharp decline in values on the New York Stock Exchange that occurred in the autumn of 1929, so that at the end of said year a number of securities remained in the Error Account for the reason that the partnership had been unable to dispose [fol. 17] thereof at prices deemed adequate during the course of such year.

8. All of the securities remaining in the Error Account on December 31, 1929, with the exception of 500 shares of New York Transportation Co. and 38 shares of Tidal Osage Oil, were disposed of by the partnership during the calendar year 1930, long prior to the time that said partnership or any member thereof had any intimation of the position the Government would endeavor to assert with respect to the issue in controversy herein.

9. In each and every year since in or about 1921 and up to February 1, 1932, said partnership had adopted a uni-

form practice of inventorying the securities in the Error Account and in the other trading accounts at their market values as of the end of each calendar month. This practice was essential in a business of the nature conducted by the partnership. The firm would not have been able to comprehend its true financial position in a business of such fluctuating values as if it had relied upon cost, and the nature of its business compelled the frequent taking of inventories evidencing the true value of securities held, in order to enable the partners to appreciate where they stood and as a basis of the credit of the partnership. Such credit was essential to its business.

10. The partnership had at all times, since it adopted the practice of inventorying securities, consistently reflected such practice with respect to the Error Account and its other accounts in its tax returns, and for the previous ten years income taxes upon its income (which was frequently enhanced by reason of the practice of inventorying securities above cost) were paid by the partners upon their distributive share of the profits so determined without any protest by the Government or any intimation that such method of inventorying the securities was improper or contrary to law.

11. The values at which the securities in said Error Account and the other trading accounts of the partnership were inventoried as of December 31, 1928 and December 31, 1929 were determined by the condition of the market for such securities as of said dates at the fair market values thereof, after full investigation and careful consideration by the members of said partnership. All of the [fol. 18] securities so held in the trading accounts, including the Error Account, were acquired for the purpose of realizing a profit upon the ultimate sale thereof in the course of the partnership's business as a dealer in securities, and none of said securities were held for the purpose of investment.

B. As respects the item of bad debts.

1. Your petitioner claims a proportionate deduction from his income subject to tax for bad debts of the partnership of Schafer Bros. aggregating $2,500, for the following advances:

To one Harold Seaman $1,000.00
To one Emil Kolb 1,000.00
And to one Reisman 500.00

These advances were all made by your petitioner for the account of the partnership in the course of its business and were all ascertained to be worthless and uncollectible in the year 1929.

Wherefore, your petitioner prays that this Board may hear this appeal and redetermine what, if any, amount your petitioner is legally liable for as deficiency tax for the year 1929, the petitioner, however, insisting and claiming that he is not liable for any deficiency tax for said period, exceeding such additional amount of tax as may be due in respect to the amounts specified in paragraphs numbered "2" and "3" contained in the deficiency letter hereto annexed.

Your petitioner hereby designates as his post office address to which notices in this proceeding be sent as Edward Schafer, care of Eugene Untermyer, No. 30 Pine Street, New York City, N. Y.

Dated, New York, May 17, 1933.

Edward Schafer. Eugene Untermyer, Attorney for Petitioner, 30 Pine Street, New York City, N. Y.

[fol. 19] *Duly sworn to by Edward Schafer. Jurat omitted in printing.*

EXHIBIT "A" TO PETITION

Treasury Department, Washington

Office of Commissioner of Internal Revenue

Mar. 21, 1933.

Mr. Edward Schafer, 120 Broadway, New York, New York.

SIR:

You are advised that the determination of your tax liability for the year 1929 discloses a deficiency of $33,423.09, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, if you do not desire to petition, you are requested to execute the inclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this form will expedite the closing of your return(s) by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the inclosed form, or on [fol. 20] the date assessment is made, whichever is earlier; whereas if this form is not filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully, David Burnet, Commissioner, by W. T. Sherwood, Acting Deputy Commissioner.

Inclosures: Statement, Form 870.

Statement

In re Mr. Edward Schafer, 120 Broadway, New York, New York

Income Tax Liability

Year	Income Tax Liability	Income Tax Assessed	Deficiency
1929.....	$36,395.13	$2,972.04	$33,423.09

The deficiency shown herein is based upon the report dated June 30, 1931, prepared by Internal Revenue Agent John J. Crowley, Jr., and transmitted to you under date of August 4, 1931, which report is made a part of this letter.

Careful consideration has been accorded your protest dated October 13, 1931, in connection with the findings of the examining officer, and the information submitted at conferences held in the office of the internal revenue agent in charge under date of November 4, 1931, and in this office under date of November 16, 1932.

The adjustments made and computation of tax follow:

Net income reported on the return		$44,335.36
Plus:		
1. Partnership income increased	$175,297.28	
2. Loss from estate disallowed	991.95	
3. Additional profit on sale of securities	1,920.83	178,210.06
Net income adjusted		$222,545.42

[fol. 21] Explanation of Changes

1. Income received from partnership of Schafer Brothers increased due to disallowing to the partnership inventory at "cost or market whichever is lower" in accordance with G. C. M. 9656—IT: Rev. Bulletin X-33.

2. Loss from Estate of S. M. Schafer represents loss covering operating and upkeep expenses of property held in estate. It is disallowed since it is properly chargeable to corpus of the estate. See T. D. 3668—Cumulative Bulletin IV-1-191.

3. Profit on sales of securities increased due to your having computed profit on a joint account by inventorying at "cost or market whichever is lower," which is not allowable. The additional profit is based on cost and is determined as follows:

E. S. #2 Account—1/3 Interest

Inventory of securities at end of year—cost	$159,762.50
Inventory of securities at end of year—claimed	154,000.00
Excess of cost over market	$5,762.50
Your one-third interest	$1,920.83

NOTE.—Profit on securities sold, which were held for over two years, has been transferred to capital net gain in the amount of $63,018.50.

Consent which will expire on June 30, 1934, except as extended by the provisions of section 277 of the Revenue Act of 1928, is on file for the year 1929.

Computation of Tax

Total net income adjusted		$222,545.42
Less:		
Capital net gain included		63,018.50
Ordinary net income adjusted		$159,526.92
Less:		
Dividends	$17,605.84	
Personal exemption and credit for dependent	3,900.00	21,505.84
Net income subject to normal tax		$138,021.08
[fol. 22] Normal tax at ½% on $4,000.00		20.00
Normal tax at 2% on $4,000.00		80.00
Normal tax at 4% on $130,021.08		5,200.84
Surtax on $159,526.92		23,565.38
Tax at 12½% on capital net gain of $63,018.50		7,877.31
Total		$36,743.53
Brought forward		$36,743.53
Less:		
Earned income credit of $27,359.95		348.40
Income tax liability		$36,395.13
Income tax previously assessed, account #311594		2,972.04
Deficiency in tax		$33,423.09

[File endorsement omitted]

BEFORE UNITED STATES BOARD OF TAX APPEALS

No. 72373

[Title omitted]

ANSWER—Filed July 1, 1933

Comes now the respondent by his attorney, E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue, and in answer to the petition of the petitioner, admits, denies and alleges as follows:

I, II and III. Admits the allegations contained in paragraphs one, two and three of the petition.

IV. (1), (2) and (3) Denies that the respondent committed errors as alleged in sub-paragraphs (1), (2) and (3) of paragraph four of the petition.

[fol. 23] V. A (1), (2) and (3) Admits the allegations contained in sub-paragraphs A (1), (2) and (3) of paragraph five of the petition.

V. A (4) to (11) Has insufficient information to form a belief as to the allegations contained in sub-paragraphs A (4) to (11) inc. of paragraph five of the petition, and hence denies the same.

V. B (1) Denies the allegations contained in paragraph five (B) (1) of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified or denied.

Wherefore, it is prayed that the petitioner's appeal be denied and the Commissioner's determination of deficiency be approved.

(Signed) E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue. DeWitt M. Evans, Special Attorney, Bureau of Internal Revenue, of Counsel.

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 72374

[Title omitted]

PETITION—Filed May 20, 1933

Leonard Schafer, the above-named petitioner, hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency for the calendar year 1929, dated March 21, 1933, and initialled IT:AR:A-1 JBW-60D, and as a basis for this proceeding alleges as follows:

I. Your petitioner is an individual, and his post office address is No. 50 Broad Street, Borough of Manhattan, City of New York, N. Y.

[fol. 24] II. The notice of deficiency, a copy of which is hereto attached and marked Exhibit A, was mailed to your petitioner under date of March 21, 1933.

III. The tax in dispute is income tax for the calendar year 1929 and is in the amount of $32,681.97.

IV. The determination of the tax set forth in said notice of deficiency is based on the following errors.

1. The disallowance of inventories of securities by the partnership of Schafer Bros. at market as of the beginning and end of the taxable year, the restoring of the value of such securities to alleged cost, and the consequent increase of income of the partnership alleged to be subject to income tax for the calendar year 1929 in the amount of $511,667.

2. The disallowance as a deduction from the income of the partnership of Schafer Bros. subject to tax of bad debts aggregating $2500;

3. The consequent increase of income of your petitioner alleged to be subject to income tax for the calendar year 1929 in the amount of $167,002.20.

V. The facts upon which the petitioner relies as a basis for this proceeding are as follows:

A. As respects the inventorying of securities:

1. The copartnership of Schafer Bros. from in or about the year 1918 up to February 1, 1932, consisted of the three brothers, Edward Schafer, Leonard Schafer (your petitioner herein) and Algernon S. Schafer, all of whom were general partners. The original firm was founded by the father of the said partners in the year 1860 and said firm, as from time to time constituted, was at all times since its formation doing business in the City of New York.

2. Said firm was and at all times hereinbefore mentioned had been since about the year 1865 a member of the New York Stock Exchange. Since its formation it had conducted

a general business as dealer and merchant in securities on commission and on margin, including as an essential part of its business the dealing in securities for the account of the partnership, and had at all times a suite of offices and an established place of business in the City of New York.

3. Since the year 1899 your petitioner had owned a seat on the New York Stock Exchange and at all times since the [fol. 25] aforesaid partnership was formed in 1918 and up to February 1, 1932, your petitioner had been the floor member of the partnership, and the two remaining partners had been its office members and both actively engaged in the conduct of its business.

4. As an essential part of its business said partnership engaged in the business of a dealer and merchant in securities by dealing therein for its own account, in most part through its own floor member, your petitioner, and at other times through other brokers. This branch of its business was conducted under numerous separate accounts that appear on its books, including an account entitled "Error Account". Transactions effected in such accounts, including the Error Account aforesaid, were for the purpose and with the expectation of realizing a profit thereon within the immediate future as a dealer in securities by their rapid turnover, and none of said securities were acquired for investment purposes or with the expectation of holding the same as investments.

5. When it was desired to acquire securities for investment the same was not effected through the partnership but for the account of the individual partners, and such securities were either withdrawn by them or credited to their separate capital accounts upon the books of the firm.

6. From time to time securities dealt in in the Error Account and other trading accounts, upon which the partnership anticipated the realization of profit at the time of acquisition, did not increase but diminished in value, in which event it became necessary, to carry out the purpose of the transaction, for the partnership to retain such securities for a period of time unanticipated at the time of their acquisition and wholly undesired, but always with the intention that said securities would be disposed of when an adequate price therefore could be obtained.

7. During the year 1929 the partnership, in the general course of its business, engaged in extensive trading operations in its various trading accounts, including the Error Account. Of the 16,738 shares on hand and inventoried at the beginning of the year 1929, 9,800 shares were sold during said calendar year. In the Error Account alone the partnership in 1929 traded in upwards of 72 different items or varieties of securities, purchased an aggregate of 107,500 shares of stock of such various securities and sold 92,500 [fol. 26] shares thereof in the Error Account. The profits anticipated were adversely affected by the sharp decline in values on the New York Stock Exchange that occurred in the autumn of 1929, so that at the end of said year a number of securities remained in the Error Account for the reason that the partnership had been unable to dispose thereof at prices deemed adequate during the course of such year.

8. All of the securities remaining in the Error Account on December 31, 1929, with the exception of 500 shares of New York Transportation Co. and 38 shares of Tidal Osage Oil, were disposed of by the partnership during the calendar year 1930, long prior to the time that said partnership or any member thereof had any intimation of the position the Government would endeavor to assert with respect to the issue in controversy herein.

9. In each and every year since in or about 1921 and up to February 1, 1932, said partnership had adopted a uniform practice of inventorying the securities in the Error Account and in the other trading accounts at their market values as of the end of each calendar month. This practice was essential in a business of the nature conducted by the partnership. The firm would not have been able to comprehend its true financial position in a business of such fluctuating values as if it had relied upon cost, and the nature of its business compelled the frequent taking of inventories evidencing the true value of securities held, in order to enable the partners to appreciate where they stood and as a basis of the credit of the partnership. Such credit was essential to its business.

10. The partnership had at all times, since it adopted the practice of inventorying securities, consistently reflected such practice with respect to the Error Account and

its other accounts in its tax returns, and for the previous ten years income taxes upon its income (which was frequently enhanced by reason of the practice of inventorying securities above cost) were paid by the partners upon their distributive share of the profits so determined without any protest by the Government or any intimation that such method of inventorying the securities was improper or contrary to law.

11. The values at which the securities in said Error Account and the other trading accounts of the partnership were inventoried as of December 31, 1928 and December 31, 1929, were determined by the condition of the market [fol. 27] for such securities as of said dates at the fair market values thereof, after full investigation and careful consideration by the members of said partnership. All of the securities so held in the trading accounts, including the Error Account, were acquired for the purpose of realizing a profit upon the ultimate sale thereof in the course of the partnership's business as a dealer in securities, and none of said securities were held for the purpose of investment.

B. As respects the item of bad debts.

1. Your petitioner claims a proportionate deduction from his income subject to tax for bad debts of the partnership of Schafer Bros. aggregating $2500, for the following advances:

To one Harold Seaman	$1,000.00
To one Emil Kolb	1,000.00
And to one Reisman	500.00

These advances were all made by Edward Schafer for the account of the partnership in the course of its business and were all ascertained to be worthless and uncollectible in the year 1929.

Wherefore, your petitioner prays that this Board may hear this appeal and redetermine what, if any, amount your petitioner is legally liable for as deficiency tax for the year 1929, the petitioner, however, insisting and claiming that he is not liable for any deficiency tax for said period, exceeding such additional amount of tax as may be due in respect to the amounts specified in paragraphs numbered "2" and "3" contained in the deficiency letter hereto annexed.

Your petitioner hereby designates as his post office address to which notices in this proceeding be sent as Leonard Schafer, care of Eugene Untermyer, No. 30 Pine Street, New York City, N. Y.

Dated, New York, May 18th, 1933.

Leonard Schafer. Eugene Untermyer, Attorney for Petitioner, 30 Pine Street, New York City, N. Y.

[fol. 28] *Duly sworn to by Leonard Schafer. Jurat omitted in printing.*

EXHIBIT "A" TO PETITION

Treasury Department, Washington

Office of Commissioner of Internal Revenue

Mar. 21, 1933.

Mr. Leonard Schafer, 120 Broadway, New York, New York.

SIR:

You are advised that the determination of your tax liability for the year 1929 discloses a deficiency of $32,681.97 as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, if you do not desire to petition, you are requested to execute the inclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this form will expedite the closing of your return(s) by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period [fol. 29] terminates thirty days after filing the inclosed form, or on the date assessment is made, whichever is earlier; whereas if this form is not filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully, David Burnet, Commissioner, by W. T. Sherwood, Acting Deputy Commissioner.

Inclosures: Statement Form 870.

Statement

IT:AR:A-1.
JBW-60D.

In re Mr. Leonard Schafer, 120 Broadway, New York, New York

Income Tax Liability

Year	Income Tax Liability	Income Tax Liability	Deficiency
1929	$35,851.88	$3,169.91	$32,681.97

The deficiency shown herein is based upon the report dated June 30, 1931 prepared by Internal Revenue Agent John J. Crowley, Jr., and transmitted to you under date of August 4, 1931, which report is made a part of this letter.

Careful consideration has been accorded your protest dated October 13, 1931, in connection with the findings of the examining officer, and the information submitted at conferences held in the office of the internal revenue agent in charge under date of November 4, 1931 and in this office under date of November 16, 1932.

[fol. 30] The adjustments made and computation of tax follow:

Net income as shown on the return		$45,306.64
Plus:		
1. Partnership income increased	$167,002.20	
2. Loss from estate disallowed	991.95	
3. Additional profit on sale of securities	1,920.83	
		169,914.98
Net income adjusted		$215,221.62

Explanation of Changes

1. Income received from partnership of Schafer Brothers increased due to disallowing inventory to the partnership at "cost or market whichever is lower" in accordance with G. C. M. 9656—IT:Rev. Bulletin X-33.

2. Loss from Estate of S. M. Schafer represents loss covering operating and upkeep expenses of property held in estate. It is disallowed since it is properly chargeable to

corpus of the estate. See T. D. 3668—Cumulative Bulletin IV-1-191.

3. Profit on sales of securities increased due to your having computed profit on a joint account by inventorying at "cost or market, whichever is lower" which is not allowable. The additional profit is based on cost and is determined as follows:

E. S. #2 Account—1/3 Interest

Inventory of securities at end of year—cost	$159,762.50
Inventory of securities at end of year—claimed	154,000.00
Excess of cost over market	$5,762.50
Your one-third interest	$1,920.83

NOTE.—Profit on securities sold which were held over two years has been transferred to capital net gain in the amount of $52,796.80.

Consent which will expire on June 30, 1934, except as extended by the provisions of section 277 of the Revenue Act of 1928 is on file for the year 1929.

[fol. 31] Computation of Tax

Total net income adjusted		$215,221.62
Less:		
Capital net gain included		52,796.80
Ordinary net income adjusted		$162,424.82
Less:		
Dividends	$16,931.85	
Personal exemption	3,500.00	
		20,431.85
Net income subject to normal tax		$141,992.97
Normal tax at ½% on $4,000.00		$20.00
Normal tax at 2% on $4,000.00		80.00
Normal tax at 4% on $133,992.97		5,359.72
Surtax on $162,424.82		24,144.96
Tax at 12½% on capital net gain of $52,796.80		6,599.60
Total		$36,204.28
Brought forward		$36,204.28

Less:	
Earned income credit on $27,359.95	352.40
Income tax liability	$35,851.88
Income tax previous-assessed, account #311595	3,169.91
Deficiency in tax	$32,681.97

[File endorsement omitted]

[fol. 32] BEFORE UNITED STATES BOARD OF TAX APPEALS

No. 72374

[Title omitted]

ANSWER—Filed July 1, 1933

Come now the respondent by his Attorney, E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue, and in answer to the petition of the petitioner, admits, denies and alleges as follows:

I, II and III. Admits the allegations contained in paragraphs one, two and three of the petition.

IV. (1), (2) and (3) Denies that the respondent committed errors as alleged in sub-paragraphs (1), (2) and (3) of paragraph four of the petition.

V. A (1), (2) and (3) Admits the allegations contained in sub-paragraphs A (1), (2) and (3) of paragraph five of the petition.

V. A (4) to (11) inc. Has insufficient information to form a belief as to the allegations contained in sub-paragraphs A (4) to (11) inc. of paragraph five of the petition, and hence denies the same.

V. B (1) Denies the allegations contained in paragraph five B (1) of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified or denied.

Wherefore, it is prayed that the petitioner's appeal be denied and the Commissioner's determination of deficiency be approved.

(Signed) E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue. DeWitt M. Evans, Special Attorney, Bureau of Internal Revenue. Of Counsel.

[fol. 33] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 72370, 72373, 72374

ALGERNON S. SCHAFER, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

EDWARD SCHAFER, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

LEONARD SCHAFER, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Findings of Fact and Opinion—Promulgated March 28, 1935

A partnership, in addition to its business as a dealer in securities, and with no relation to its customers in that branch of its business, made substantial purchases of securities for the purpose of resale, to any buyer, at a profit, upon an expected rise in the market. Neither the relative amount nor the necessity of that additional business to its business as such a dealer, was established. Held, respondent's determination that such partnership is not a dealer in securities within article 105, Regulations 74, as to such additional branch of its business, and is, therefore, not entitled to inventory, at market value, the securities pur-

chased in connection with that additional business and carried in a special account, will not be disturbed.

Eugene Untermyer, Esq., for the petitioner.
R. W. Wilson, Esq., for the respondent.

These consolidated proceedings seek redetermination of income tax deficiencies, for the calendar year 1929 in the amount of $33,329.20 against Algernon S. Schafer, $33,423.09 against Edward Schafer, and $32,681.97 against Leonard Schafer.

[fol. 34] During 1929 petitioners were members of the partnership of Schafer Bros. The disputed taxes are based upon their respective incomes as such parties. They assign as error: (1) The respondent's determination that the partnership of Schafer Bros. was not entitled to inventory at market value, securities on hand at the beginning and end of the year 1929, and (2) that the partnership was not entitled to deduct, in same year, alleged bad debts aggregating $2,500, resulting in a substantial increase in the net income each petitioner derived from the partnership. At the hearing, the parties limited the first issue to the sole question of whether the partnership was entitled to inventory securities in a so-called "Error Account" on the partnership books at the beginning and end of the year 1929. A portion of the facts has been stipulated.

Findings of Fact

From 1918 to February 1932, the petitioners, residents of New York, were general partners with a one-third interest each, in the partnership of Schafer Bros., which had its principal office at 120 Broadway, New York City. The original firm of Schafer Bros. was founded in 1860 by petitioners' father and, as constituted from time to time, it has conducted a general brokerage business in New York City. Since about 1865 the firm has been a member of the New York Stock Exchange.

Leonard Schafer has owned a New York Stock Exchange seat since 1899. During the existence of the partnership involved in these proceedings, including 1929, Leonard Schafer was the floor member while the other two petitioners were the office members. Leonard Schafer was also a specialist in one or two stock issues. All three petitioners

were actively engaged in the partnership business, which, throughout the period from 1918 to 1932, included several activities in relation to securities. The partnership was a dealer and merchant in securities on commission and on margin. Such business activity comprised the execution of orders for purchase or sale of securities by its customers either on the Exchange, the Curb, or wherever the particular securities were listed. From 1925 through 1929 the partnership participated in a great number of syndicate and underwriting operations. Also, as a part of its business [fol. 35] activities, but with no relation to its customers' accounts nor to the execution of orders for its customers, the partnership has always, to some extent, bought and sold securities for its own account.

Beginning in 1925 or 1926 and continuing through 1929, the partnership traded in securities for its own account, much more extensively than had been its practice prior to 1925. Such trading was conducted through orders executed by Leonard Schafer or other brokers and had no relation to or connection with the accounts of the partnership's customers, but were purchased in expectation of a rise in the market price and for the purpose of resale, to any buyer, at a profit for the partnership's own account. Such securities were not purchased for investment. Sales of those securities were made through orders given Leonard Schafer or other brokers and the identity of the purchasers was not known. Such purchases and sales were entered in the so-called "Error Account" (the name having no significance), which was just an old account carried on the books and used for the partnership's own transactions in securities. During 1929, the partnership purchased 107,500 shares and sold 92,500 shares of 72 different issues of securities, entered in the "Error Account." The number of such securities carried at the close of 1929 was unusually large, due to the drop in the market and the inability to sell at a profit. However, all but a comparatively few shares were sold during 1930.

Prior to 1925 the partnership carried its own securities in the "Error Account" at cost, but beginning with that year, and including 1929, it has inventoried, at fair market

value, the securities held for its own account at the beginning and end of the year. The change was made as a matter of business policy, but with knowledge of the effect of the taxing statutes. The New York Stock Exchange, since about 1923, has required its members to inventory securities for the purpose of certain Exchange questionnaires.

At the close of business on December 31, 1928 and 1929, the partnership owned, and carried in the "Error Account," the securities specified and described in Exhibits "B" and "C," respectively (attached to the stipulation and included herein by reference), which exhibits also set forth [fol. 36] the actual cost and the fair market value of such securities, totaling as follows:

	Actual cost	Fair market value	Cost over market
December 31, 1928....	$332,982	$298,732	$34,250
December 31, 1929....	1,527,882	981,965	545,917

The Commissioner determined that the partnership was not a dealer with respect to such securities and that they must be carried at cost. He disallowed the use of inventories and increased the partnership income by the amount of $511,667, the difference between cost over market value at the beginning and the end of the year 1929.

Harold Seaman, a boat builder, asked Edward Schafer for a loan of $1,000 by the firm. Schafer, having granted Seaman many favors, advanced the $1,000 although Seaman was not worth anything, Edward Schafer, acting for the firm, loaned Emil Kolb, a mechanic and inventor, $1,000 upon the latter's request, and Schafer has been giving Kolb money ever since. Edward Schafer loaned $500 to one Reissler, a poor man in the radio business. Subsequently Reissler went through bankruptcy proceedings. At various times, including the year 1929, Schafer made several requests for repayment of the three loans, but all three debtors were insolvent and no part of the loans has ever been collected.

Opinion

Leech:

The respondent has determined that, as to the securities carried in the so-called "Error Account," the Schafer Bros.

partnership was not, during 1929, a "dealer in securities" within the meaning of article 105, Regulations 74[1] promulgated by the explicit authority of section 22 (c) of the [fol. 37] Revenue Act of 1928,[2] and was not entitled, under that statute and regulation, to inventory, at market, its securities carried in that account in computing its income

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[1]Art. 105. Inventories by dealers in securities.—A dealer in securities who in his books of account regularly inventories unsold securities on hand other—

(a) At cost;

(b) At cost or market, whichever is lower; or

(c) At market value,

may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the Commissioner. For the purpose of this rule a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation and not in the course of an established business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule.

[2] (c) Inventories.—Whenever in the opinion of the Commissioner to use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

tax for that year. The first issue here involves only the question of whether, upon this record, that determination shall be reversed.

That regulation has been approved as a reasonable application of the statute. Northeastern Surety Co., 29 B. T. A. 297; Oil Shares, Inc., 29 B. T. A. 664. Since respondent's disputed determination was the result of the exercise of an administrative discretion definitely committed to him by statute, difficult as it may be to evaluate presumptions for practical comparison, petitioners' burden in overcoming that determination is undoubtedly heavier than that of overthrowing the general presumption of correctness arising upon all determinations of tax liability by respondent. Alfred E. Hamill, 30 B. T. A. 955; Albert Fried, 31 B. T. A. 638; Frederic H. Brendle, 31 B. T. A. 1188.

There can be no doubt that an individual, partnership, or corporation may engage, at the same time, in more than one distinct branch of business activities, and that one of those may be that of "dealer in securities." Cf. Harriman National Bank v. Commissioner, 43 Fed. (2d) 950. These separate activities may even all have to do with the purchase and sale of securities, but not all be those of a "dealer in securities." James B. Lowell, 30 B. T. A. 1297; Northeastern Surety Co., supra; Frederic H. Brendle, supra. However, the purpose of the statute and the quoted regulation was to provide a means for the correct reflection of income resulting from a definitely limited character of business. Obviously, this purpose would not be furthered by [fol. 38] permitting the use of this privileged method of tax computation to income from business activities which are not within the controlling regulation in question. The fact that a taxpayer maybe a statutory dealer in securities as to some of its activities, does not, alone, entitle him to return income from its other and different activities, computed by that privileged method.

This record does not disclose that the activities of the Schafer Bros. firm, reflected in the "Error Account," were essential to its business as a "dealer in securities." The ratio of those activities to the entire partnership business is not shown. However, it does appear that those activities were quite substantial. Certainly, at least, in such circumstances, the partnership is entitled to inventory only those securities purchased in its business or branch of business

of dealing in securities as defined by the regulation. That regulation, itself, provides for such a segregation and different treatment for tax purposes of the income from separate branches of a business. Cf. Harriman National Bank v. Commissioner, supra.

The testimony in these proceedings is very clear and positive as to the purpose and character of the transactions covering the securities carried in the "Error Account." During the year 1929, the partnership purchased those securities through orders executed by Leonard Schafer, or other brokers on any exchange on which the desired securities were listed. If the market price went up, those securities were sold through the execution of orders given to Leonard Schafer or other brokers. The identity of the purchasers of such securities was not known to the members of the partnership. The purchase and sale of securities in the "Error Account" had no relation to the parnership's customers' accounts or connection with the execution of orders given by its regular customers. They were purchased solely in expectation of a rise in the market, for the partnership's own account for resale, to any buyer, at a profit.

The meaning of "dealer in securities," as defined in the controlling regulation, has been considered many times by the courts, and this Board. It is limited to one who, as a merchant, buys and sells securities to customers for the profit thereon.

[fol. 39] It is unnecessary here to attempt an abstract description of what this definition includes, since it is clear that the transactions of the partnership, recorded in the "Error Account," were not within its boundaries.

Thus, except for customers in the sense that any speculator must have someone to whom he sells, which is not sufficient to bring the partnership within the regulation, it is not shown that as to the securities carried in the "Error Account," the partnership had customers—an essential requisite of the controlling definition. Albert Fried, supra. The stocks in dispute were purchased for the firm's own account solely in expectation of a rise in the market, for sale to anyone at a profit, "as distinguished from a purchase to create a stock of securities to take care of future buying orders in excess of selling orders." Frederic H. Brendle, supra. So far as this record discloses, as to this

branch of the partnership business, it was apparently a speculator and not a "dealer" within the regulation. Adirondack Securities Corporation, 23 B. T. A. 61; Oil Shares, Inc., supra.

It is contended for petitioners further that, inasmuch as the partnership has followed the practice of inventorying its securities at market in determining its income since 1925 it should be permitted, as a matter of course, to follow the same practice for the year 1929, here involved. Important as is the evidence of such prior practice of the partnership (Alfred E. Hamill, supra), it cannot be and is not controlling here, since we are concerned directly with only the year 1929. Even if the relevant facts pertaining to the securities carried in the "Error Account" in those prior years were similar to the facts appearing here as to 1929, and the respondent approved the partnership's return of income therefrom as a "dealer in securities," that approval certainly does not constitute more than a determination for those earlier years. It does not foreclose a change in such determination as to 1929. To do so would permit the perpetuation of an error, a result not only repugnant to common sense, but certainly not within the clear intent of the statute. Cf. Smith Paper Co., 31 B. T. A. 28; W. C. Mitchell Co., 27 B. T. A. 645.

Petitioners argue also that the partnership used the inventory method in reporting income for 1929. There was oral testimony to that effect. But the partnership return [fol. 40] for that year, admitted in evidence as such, without objection does not corroborate that contention. Nothing appears in that return after the titles "Inventory at beginning of year" and "Less inventory at end of year." Nor does the record disclose that either in that return or attached thereto was there a description of the method or basis upon which the questioned accounts of the partnership were kept. This is also fatal to the inventory privilege for the partnership. William W. Vaughan, 31 B. T. A. 548.

In any event, petitioners have not sustained their burden of establishing error in respondent's determination that the partnership of Schafer Bros. was not a "dealer in securities" in reference to the "Error Account" within the meaning of the regulation. Nor have they shown its compliance with the conditions, provided in that regulation,

precedent to the right to inventory securities carried in that account in determining income for the year 1929.

As to the second issue, involving the deductibility of certain alleged bad debts, the facts are insufficient to support a reasonable determination that the debts actually become worthless during 1929. The record indicates that the debts became worthless at the time the loans were made. Their deduction in computing taxable income for 1929 was properly denied. Eckert v. Burnet, 283 U. S. 140; Avery v. Commissioner, 22 Fed. (2d) 6; Paul Pryibil, 31 B. T. A. 164; J. Edgar Davidson et al., Executors, 26 B. T. A. 754.

The respondent's determination is approved.
Review by the Board.
Decision will be entered for respondent.

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 72370

[Title omitted]

DECISION

Pursuant to the determination of the Board, as set forth in its report promulgated March 28, 1935, it is ordered [fol. 41] and decided: That there is a deficiency of $33,329.20 for the calendar year 1929.

Enter.

(Signed) Eugene Black, Member. [Seal U. S. Board of Tax Appeals.]

Entered Nov. 30, 1935.

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 72373

[Title omitted]

DECISION

Pursuant to the determination of the Board, as set forth in its report promulgated March 28, 1935, it is ordered

and decided: That there is a deficiency of $33,423.09 for the calendar year 1929.

Enter.

(Signed) Eugene Black, Member. [Seal U. S. Board of Tax Appeals.]

Entered Mar. 30, 1935.

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 72374

[Title omitted]

DECISION

Pursuant to the determination of the Board, as set forth in its report promulgated March 28, 1935, it is ordered [fol. 42] and decided: That there is a deficiency of $32,681.97 for the calendar year 1929.

Enter.

(Signed) Eugene Black, Member. [Seal U. S. Board of Tax Appeals.]

Entered Mar. 30, 1935.

[File endorsement omitted]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 72370, 72373, 72374

(Consolidated Proceeding)

[Title omitted]

STIPULATION REGARDING JURISDICTION ON REVIEW—Filed June 21, 1935

It is stipulated and agreed by and between the parties hereto that the decision of the Board of Tax Appeals in the above entitled cause which has been duly consolidated by order of said Board, may be reviewed by the Court of Appeals of the District of Columbia. This agreement is

made and filed pursuant to Section 1002 (d) of the Revenue Act of 1926, as amended by Section 519 (a) of the Revenue Act of 1934.

Algernon S. Schafer, Edward Schafer, Leonard Schafer, Petitioners, by Eugene Untermyer, Their Attorney. Guy T. Helvering, Commissioner of Internal Revenue, Respondent, by Frank J. Wideman, Assistant Attorney General.

[fol. 43] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 72370, 72373, 72374

(Consolidated Proceeding)

[Title omitted]

PETITION FOR REVIEW—Filed June 21, 1935

To the Honorable the Chief Justice and Associate Justices of the Court of Appeals of the District of Columbia:

Your petitioners, Algernon S. Schafer, Edward Schafer and Leonard Schafer, respectfully show:

I

Jurisdiction for Review

This is a proceeding pursuant to the provisions of Section 1001 of the Revenue Act of 1926, as amended by Section 1101 of the Revenue Act of 1932, for review by the Court of Appeals of the District of Columbia of a decision of the United States Board of Tax Appeals entered on the 28th day of March, 1935, and redetermining a deficiency of income taxes for the calendar year 1929 against your petitioner Algernon S. Schafer, in the amount of $33,329.20, your petitioner Edward Schafer in the amount of $33,423.09, and your petitioner Leonard Schafer in the amount of $32,681.97.

Each of your petitioners at the time of filing this petition is, and for considerable time prior thereto was, a citizen of the United States and an inhabitant of the City of New York, State of New York.

By order of the Board, the three proceedings were consolidated, and the appeal will be prosecuted on the same record.

On the 28th day of May, 1935, counsel for petitioners and counsel for respondent entered into an agreement [fol. 44] under and pursuant to the provisions of Section 1002 (d) of the Revenue Act of 1926, as amended by Section 519 (a) of the Revenue Act of 1934, that the decision of the United States Board of Tax Appeals in said consolidated proceeding should be reviewed by the Court of Appeals of the District of Columbia.

II

Nature of Controversy

The controversy in these cases before the United States Board of Tax Appeals, so far as pertinent, concerns the refusal of the Respondent, the Commissioner of Internal Revenue, in computing and determining the taxable net income of each of your petitioners for the year 1929, to compute and determine the amount to be included therein as income derived from Schafer Brothers, a copartnership (herein sometimes called "firm" or "partnership"), and which represented the distributable share of each of your petitioners of the income of said partnership, by inventorying securities owned by said partnership on January 1, 1929, and December 31, 1929, at the fair market value thereof, pursuant to the provisions of Section 22(c) of the Revenue Act of 1928.

As a result of the action of said Respondent in refusing to compute and determine the income of said partnership by use of inventories of the securities owned by it in 1929, and as a result of the decision herein by which said action of respondent was approved, the taxable net income for the year 1929 of each of your petitioners, each of whom had a one-third interest in said partnership was, erroneously, substantially increased.

The firm of Schafer Brothers was founded many years ago by the father of the petitioners, and the present partnership was formed in 1918. For many years prior thereto, said firm was a member of the New York Stock Exchange and, between 1918 and 1932, had a suite of offices and an established place of business at No. 120 Broadway,

Borough of Manhattan, City of New York, and during the year 1929 and for many years prior thereto each of your petitioners was actively engaged in the conduct of its business.

[fol. 45] During the year 1929 and for many years prior thereto, the firm engaged actively in the business of buying and selling securities for resale to customers, including underwritings and syndicate operations, in buying and selling securities for the account of the firm, and executing orders for customers to buy and sell on commission.

Transactions in securities for the account of the firm were handled through an account entitled "Error Account" and during the year 1929 transactions in said account constituted a substantial portion of the firm's business.

At the beginning and end of the year 1929 the firm owned securities none of which were purchased for investment and all of which were inventoried on its books at their fair market value as at the beginning and end of 1929, respectively. The Respondent has compelled the firm to restate said securities at cost. Substantially all of the securities so owned on January 1, 1929, were sold during that year, and substantially all of the securities owned on December 31, 1929, were sold during 1930.

The respondent and the petitioners have stipulated that the values shown on the books and reflected in the tax return of the partnership for the year 1929 were the respective fair market values thereof on January 1st, 1929, and December 31st, 1929, respectively.

By the rules and regulations of the New York Stock Exchange adopted in about 1923, the partnership has, in each year commencing in 1925 and including the calendar year 1929, inventoried securities owned by said partnership at their fair market values, which values are reflected on its books. During the same years, the partnership had determined its taxable income upon the inventory of values so arrived at at the beginning and end of each taxable year, and has reflected such values in the tax returns of the partnership and in the individual tax returns of the petitioners.

At all times up to the year 1929, respondent accepted and approved the partnership returns and corresponding individual returns for the partners on the basis of the inventories of securities owned by the partnership and reflected in said returns, and in 1929, for the first time, the

Respondent compelled the partnership to apply the factor of cost to the securities owned by it at the beginning and end of that year.

[fol. 46] During 1929 and for many years prior thereto, the fiscal year of the partnership and of your petitioners was the calendar year, and petitioners were the only partners in the firm.

On appeal to the United States Board of Tax Appeals, the final administrative agency of the executive branch of the Government, said Board affirmed the action of Respondent in refusing to determine the income for the year 1929 of the firm (and the resultant income of each of your petitioners) upon the basis of inventories of its securities at their fair market values, and declined to permit the use of inventories.

The question is whether the determination of the Board and the course of action pursued by respondent was proper under the law and the evidence, and whether or not material evidence offered by petitioners was properly excluded by the Board.

III

Assignments of Error

Your petitioners believe and aver that errors were committed by the United States Board of Tax Appeals to petitioners' damage and prejudice, as shown by the following assignments of error:

1. The Board erred in holding that the respondent did not err in refusing to determine the distributable income of said partnership upon the basis of inventorying the securities owned by said partnership at the beginning and end of 1929 at the market value thereof.

2. The Board erred in failing to determine that the respondent should have applied the inventory method of determining the value of securities owned by said partnership at the beginning and end of 1929, in order clearly to determine the distributable taxable income of said partnership, and the corresponding income taxable to the petitioners.

3. The Board erred in refusing to hold that the partnership was, during the year 1929, a dealer in securities pur-

chased and sold for the account of the partnership, including the securities owned by it at the beginning and at the end of said taxable year.

[fol. 47] 4. The Board erred in failing to hold that the use of inventories was necessary with respect to securities owned by the partnership at the beginning and end of the year 1929 in order clearly to determine the income of the partnership and the corresponding distributable income of the petitioners.

5. The Board erred in failing to hold that the partnership was justified in inventorying securities owned by it at the beginning and end of the year 1929 in accordance with the statutes in such case made and provided and in reliance upon previous rulings of the Respondent that the use of such practice was lawful and proper.

6. The Board erred in rejecting evidence tending to establish that the taxable income of the partnership and the resulting Federal income taxes of the petitioners in years previous to 1929 was greater because of the firm's practice of inventorying its securities, than such taxes would have been had such securities so owned by the partnership at the beginning and end of such taxable years been taken up at cost.

7. The Board erred in its determination that the partnership return filed for the calendar year 1929 did not describe the method and basis upon which the securities owned by the partnership at the beginning and end of said calendar year were inventoried.

8. The Board erred in refusing to hold that the evidence presented and the facts and circumstances disclosed by the record overcame Respondent's determination whereby he refused to permit the use of inventories with respect to securities owned by the partnership at the beginning and end of 1929.

9. The Board erred in refusing to hold that the nature of the business of said partnership compelled the use of inventories with respect to securities owned by the partnership at the beginning and end of 1929.

10. The Board erred in disregarding the effect of the rules and regulations of the New York Stock Exchange,

of which said partnership was a member and by which rules and regulations said partnership was consequently bound.

11. The Board erred in refusing to find that the stipulation between the parties to said proceeding respecting the [fol. 48] fair market value of the securities owned by said partnership at the beginning and end of 1929 complied with the regulations of the respondent.

12. The Board erred in disregarding the effect of said firm's right, under the exceptions contained in Section 118 of the Revenue Act of 1928, to sell and repurchase securities owned by it within thirty days and to deduct any resulting losses, and that said firm refrained from exercising such rightful privilege in reliance upon previous rulings of respondent permitting it to inventory securities owned by it at the beginning and end of the calendar year 1929.

13. The Board erred in disregarding the evidence that said partnership refrained from exercising its rights to sell and repurchase, during the year 1929, the securities owned by it at the end of 1929 and to deduct losses resulting from such sales, as permitted by Section 118 of the Revenue Act of 1928.

14. The ruling and determination of the respondent and the holding and decision of the Board herein impair the constitutional rights of the petitioners and violate the provisions of the Constitution of the United States, thereunto made and provided.

15. The Board erred in refusing to hold that the distributable income of the partnership for the calendar year 1929 should be computed on the basis of inventorying securities owned by said partnership at the beginning and end of said taxable year, and that the income of the petitioners, as members of said partnership, should be redetermined accordingly.

16. The Board erred in entering its decision of redetermination that the petitioner Algernon S. Shafer owes a deficiency of income taxes for the calendar year 1929 of $33,329.20.

17. The Board erred in entering its decision of redetermination that the petitioner Edward Schafer owes a

deficiency of income taxes for the calendar year 1929 of $33,423.09.

18. The Board erred in entering its decision of redetermination that the petitioner Leonard Schafer owes a deficiency of income taxes for the calendar year 1929 of $32,681.97.

[fol. 49] Wherefore, your petitioners pray that the decision of the Board of Tax Appeals entered herein be reviewed and reversed by this Honorable Court insofar as it relates to the refusal to compute and determine the distributable income of said petitioners from the partnership of Schafer Brothers and their corresponding tax liability for the calendar year 1929 upon the basis of inventorying securities owned by said partnership at the beginning and end of the calendar year 1929 at the fair market value thereof, as stipulated in said proceedings, and for such other and further relief as the Court may deem meet and proper in the premises.

Algernon S. Schafer, Edward Schafer, Leonard Schafer, Petitioners.

Duly sworn to by Eugene Untermyer. Jurat omitted in printing.

[fol. 50] [File endorsement omitted]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 72370, 72373, 72374. Consolidated Proceeding

[Title omitted]

NOTICE OF FILING PETITION FOR REVIEW—Filed June 21, 1935

To Robert H. Jackson, Esq., Assistant General Counsel, Bureau of Internal Revenue, Washington, D. C.:

Please take notice, and you are hereby notified, that the petitioners on the 21st day of June, 1935, will file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the Court of Appeals of the District of Columbia, of the decision of the Board heretofore rendered in the above-entitled case.

A copy of said petition for review and assignment of errors as filed is hereto attached and served upon you.
Dated June 21st, 1935.

Respectfully, Eugene Untermyer, Attorney for Petitioners, 30 Pine Street, New York City, 716 Investment Building, Washington, D. C.

Personal service of the foregoing notice, together with a copy of petition for review and assignment of errors mentioned therein, is hereby admitted this 21st day of June, 1935.

Robert H. Jackson, Assistant General Counsel, Bureau of Internal Revenue.

[fol. 51] [File endorsement omitted]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 72370, 72373, 72374. Consolidated Proceeding

ALGERNON S. SCHAFER, EDWARD SCHAFER, and LEONARD SCHAFER, Petitioners,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue, Respondent

Statement of Evidence—Lodged August 6, 1935; Filed August 7, 1935

The above proceedings came on for hearing at New York, New York, before Hon. J. Russell Leech, Member of the United States Board of Tax Appeals, on the 28th day of February, 1934, there being present the petitioners and respondent, by their respective counsel.

Before the hearing, the parties, through their respective counsel, entered into and filed at the hearing stipulations respecting certain facts in the case, which read as follows:

Docket No. 72373

[Title omitted]

STIPULATION OF FACTS—Filed February 28, 1934

It is hereby stipulated and agreed by the petitioner, Edward Schafer (hereinafter sometimes called "Taxpayer"), and the Commissioner of Internal Revenue (hereinafter sometimes called "Respondent"), by their respective attorneys, that the following facts are true:

1. Petitioner is an individual whose post office address is 1 Wall Street, in the Borough of Manhattan, City of New [fol. 52] York, and during the calendar year 1929 was a partner in the general partnership of Schafer Brothers (hereinafter sometimes called "Partnership"), then with principal offices and place of business at 20 Broadway, in the Borough of Manhattan, City of New York. The Partnership was formed in 1918.

2. The notice of deficiency, a copy of which is annexed to the petition herein as Exhibit "A", was mailed to the Taxpayer under date of March 21, 1933.

3. The petition herein, verified May 17, 1933, was filed with this Board on May 20, 1933.

4. The tax in dispute is income tax for the calendar year 1929 and is in the amount of $33,423.09.

5. The Partnership, from in or about the year 1918 up to February 1, 1932, consisted of the Taxpayer and his two brothers, Leonard Schafer and Algernon S. Schafer, all of whom were general partners. The original firm of Schafer Brothers was founded by the father of said partners in or about the year 1860 and said partnership, as from time to time constituted, was at all times since its formation doing business in the City of New York.

6. The firm of Schafer Brothers since long prior to the year 1913, has been and at all times mentioned in this stipulation was a member of the New York Stock Exchange.

7. At all times mentioned in this stipulation, the Partnership has had a suite of offices and established place of business in the City of New York.

8. Since the year 1899, Leonard Schafer aforesaid had owned a seat on the New York Stock Exchange and at all times since the formation of the Partnership in 1918 and

up to February 1, 1932, said Leonard Schafer was the floor member of the Partnership and the two remaining partners, including the Taxpayer, were its office members, both actively engaged in the conduct of the business.

9. During substantially all of the time since its formation in 1918 mentioned in this stipulation, the Partnership, in the course of its business, bought and sold securities, both those listed in the New York Stock Exchange and other securities, for its own account. The transactions were in most part handled through said Leonard Schafer, the floor member of the Partnership, but at times through other brokers. Said branch of its business was conducted under [fol. 53] numerous separate accounts that appear on its books, frequently arbitrarily named and numbered, including therein an account entitled "Error Account."

10. During the year 1929, the Partnership, in the general course of its business, engaged in extensive purchases and sales of securities in its various trading accounts, including the Error Account.

11. At the close of business on December 31, 1928, the Partnership owned the securities specified and described in Exhibit "B" to this stipulation, which is hereby made a part hereof. Said securities were carried in the Error Account. The first column of figures in said Exhibit "B" shows the fair market value of each item of said securities on said date; the second column of figures in said Exhibit "B" shows the cost to the Partnership of each such item.

12. At the close of business on December 31, 1929, the Partnership owned the securities specified and described in Exhibit "C" to this stipulation, which is hereby made a part hereof. Said securities were carried in the Error Account. The first column of figures in said Exhibit "C" shows the fair market value of each item of said securities on December 31, 1929; the second column of figures in said Exhibit "C" shows the cost to the Partnership of each such item.

13. All facts set forth in this stipulation or in any exhibit thereto are competent evidence in this proceeding, but nothing herein contained shall preclude either party from objecting to any one or more statements of fact herein contained on the ground of irrelevancy or immateriality.

14. Each of the parties to this stipulation reserves the

right to introduce additional evidence not inconsistent with this stipulation.

Dated, New York, February 14, 1934.

Eugene Untermyer, Attorney for Petitioner. E. Barrett Prettyman, Attorney for Respondent.

[fol. 54]

EXHIBIT "B" TO STIPULATION

Inventory as at December 31, 1928.

Quantity.	Security.	Fair Market Value.	Actual Cost.
1,000	South American Gold	$3,000.00	$3,000.00
500	N. Y. Transportation	22,500.00	22,500.00
38	Tidal Osage	532.00	532.00
300	Woodworth Pfd	11,700.00	7,500.00
1,500	Fansteel Products	18,000.00	29,712.50
200	National Radiator	3,000.00	6,125.00
2,000	General Baking	20,000.00	29,862.50
3,000	Remington Rand	90,000.00	87,300.00
3,000	Brown Boverie	48,000.00	49,525.00
3,200	Universal Pipe	64,000.00	79,550.00
2,000	C. M. W.	18,000.00	17,375.00
		$298,732.00	$339,982.00
Net increase of cost over market			$34,250.00

EXHIBIT "C" TO STIPULATION

Inventory as at December 31, 1929.

Quantity.	Security.	Fair Market Value.	Actual Cost.
1,000	South American Gold	$1,500.00	$3,000.00
500	N. Y. Transportation	10,000.00	22,500.00
38	Tidal Osage	190.00	532.00
200	National Radiator	300.00	6,125.00
300	National Radiator	600.00	2,100.00
3,200	Universal Pipe	9,600.00	79,550.00
800	Universal Pipe	2,400.00	7,200.00
2,000	General Baking	7,500.00	29,862.50
400	Rutland Preferred	24,000.00	27,600.00
300	International Cement	16,800.00	23,750.00
1,000	Warner	20,000.00	34,825.00
2,000	Northern Pacific	169,000.00	221,987.50
2,000	Electric Boat	9,500.00	19,837.50
2,500	Alleghany Corp	57,500.00	130,000.00
100	Niagra Hudson	1,150.00	2,637.50
1,000	Radio	41,250.00	98,187.50
1,000	Consolidated Gas	94,000.00	156,250.00
2,000	Shattuck	72,000.00	123,850.00
2,000	Murray Corp	37,000.00	70,000.00
500	United Corporation	14,625.00	26,500.00
1,000	International Combustion	5,750.00	38,275.00
500	Chrysler	17,500.00	28,082.50
500	Eastman-Kodak	87,000.00	95,250.00
500	New York Dock	17,500.00	17,500.00
1,500	Phila. and Reading Coal	18,000.00	17,500.00
2,100	Oppenheim Collins	94,000.00	96,600.00
1,000	Lehman Corp	73,000.00	69,000.00
1,000	St. Paul Preferred	41,500.00	42,000.00
400	Alleghany Preferred	38,200.00	37,800.00
		$981,965.00	$545,917.00
Net increase of cost over market, 12/31/28			$34,250.00
Net difference—held taxable			$511,667.00

[fol. 55] Docket No. 72370

[Title omitted]

STIPULATION—Filed February 28, 1934

It is hereby stipulated and agreed by the petitioner, Algernon S. Schafer (herein sometimes called "Taxpayer"), and the Commissioner of Internal Revenue (hereafter sometimes called "Respondent"), by their respective attorneys, that the facts stipulated in the case of Edward Schafer against Commissioner of Internal Revenue (Docket No. 72373) shall stand as and for the facts stipulated in this proceeding, and that each and all of the provisions of said stipulation shall apply to this proceeding, save and except that the first sentence of Paragraph "5", for the purpose of this proceeding, shall read as follows:

"The Partnership, from in or about the year 1918 up to February 1, 1932, consisted of the Taxpayer and his two brothers, Leonard Schafer and Edward Schafer, all of whom were general partners."

and that the tax in dispute set forth in Paragraph "4", shall be changed to $33,329.20.

It is further stipulated that Exhibit "B" and "C" of said stipulation stand as and for Exhibits "B" and "C" to this stipulation.

Dated, New York, February 14, 1934.

Eugene Untermyer, Attorney for Petitioner. E. Barrett Prettyman, Attorney for Respondent.

[fol. 56] Docket No. 72374

[Title omitted]

STIPULATION—Filed February 28, 1934

It is hereby stipulated and agreed between the Petitioner, Leonard Schafer (hereinafter sometimes called "Taxpayer") and the Commissioner of Internal Revenue (hereinafter sometimes called "Respondent"), by their respective attorneys, that the facts stipulated in the case of Edward Schafer against Commissioner of Internal Revenue

(Docket No. 72373) shall stand as and for the facts stipulated in this proceeding, and that each and all the provisions of said stipulation shall apply to this proceeding, save and except:

1. That the address "1 Wall Street", appearing in Paragraph "1," shall be changed to "50 Broadway".

2. That the first sentence of Paragraph "5", for the purpose of this proceeding, shall read as follows:

"The partnership, from in or about the year 1918 up to February 1, 1932, consisted of the Taxpayer and his two brothers, Edward Schafer and Algernon S. Schafer, all of whom were general partners."

3. That Paragraph "8", for the purpose of this proceeding, shall read as follows:

"8. Since the year 1899, the Petitioner had owned a seat on the New York Stock Exchange and at all times since the formation of the Partnership in 1918 and up to February 1, 1932, the Petitioner was the floor member of the Partnership, and the two remaining partners were its office members both actively engaged in the conduct of its business."

4. That the words "said Leonard Schafer", appearing in Paragraph "9", shall be changed to "Petitioner."

[fol. 57] 5. That the tax in dispute, set forth in Paragraph "4", shall be changed to $32,681.97.

It is further stipulated that Exhibits "B" and "C" to said stipulation shall stand as and for Exhibits "B" and "C" to this stipulation.

Dated, New York, February 14, 1934.

Eugene Untermyer, Attorney for Petitioner. E. Barrett Prettyman, Attorney for Respondent.

There follows herewith a statement in narrative form of the evidence adduced at the hearing in the above entitled cause which in addition to the aforesaid stipulations of fact, is considered material for a review of the decision entered herein by the United States Board of Tax Appeals under the assignments of error set forth in petitioners' petition to the Court of Appeals of the District of Columbia:

WILLIAM F. CORNELL, called as a witness by the petitioners, testified that he had been connected with Schafer Brothers for 26 or 27 years and had been employed by the present firm since its inception in 1918. Since that time he had had supervision over the books of the partnership.

Since the formation of the present partnership, in 1918, until about 1925 the business comprised the execution of orders for customers, the execution of orders on the Exchange for brokers, participation in the issue of securities, and dealing in securities for the account of the firm.

Trading or dealing in securities for the firm's account was practically all recorded in an account more or less arbitrarily described as the "Error Account."

About 1925 or 1926, the firm enlarged its policy of dealing in securities and participating in syndicates and participations.

There was introduced in evidence, as Petitioners' Exhibit 1, hereto annexed, a schedule representing various securities in which the firm had an interest, by way either of participations or syndicates, from 1926 to and including 1929.

Until the end of 1924, securities owned by the partnership at the end of the year were taken up at cost on its [fol. 58] books. Beginning at the end of 1924 and since that time, under the instructions of Mr. Edward Schafer, one of the petitioners and a partner in the firm, securities owned by the partnership were inventoried on the books at market value. Up to 1926 they were inventoried once a year, at the end of the calendar year. From 1926 on, the securities in the individual accounts, including the "Error Account," were inventoried monthly. Over that entire period, including 1929, the fiscal year of the partnership was the calendar year.

At the end of 1929, the firm had on hand a greater amount of securities than in prior years, partly because of the drop in the market which had made it impossible to sell them out to advantage.

No investment accounts were carried in the books of the partnership, it being its practice to show all investments in the personal accounts of the members of the firm. Investments so carried were in every instance carried at cost to the particular member of the partnership.

The witness had by request caused the books to be examined to ascertain whether the inventorying of securities owned by the partnership at the beginning and end of those years would have increased or decreased the distributable income of the partnership for prior years over the amount of such income had the securities been carried at cost. For 1928, the inventorying of securities at market decreased the amount of distributable income; for 1927, the amount of distributable income was increased by reason of inventorying at market the securities so owned by the partnership, in lieu of carrying them at cost.

And thereupon counsel for petitioners propounded the following question:

"Q. Then, just state how much the income of the partnership was increased as a result of the inventorying of securities in 1927."

to which question counsel for respondent objected on the ground that the answer called for by the question was immaterial. The objection was sustained, whereupon counsel for petitioners noted an exception, which was allowed.

The witness testified that he had computed the amount of additional Federal income tax paid in 1927 by the three [fol. 59] partners, the petitioners herein, as a result of having inventoried securities in that year instead of taking them at cost.

Counsel for petitioners propounded the following questions:

"Q. Will you state what the amount of this additional tax was?"

to which question counsel for respondent objected on the ground that the answer called for by the question was immaterial. The objection was sustained, whereupon counsel for petitioners noted an exception, which was allowed.

Counsel for petitioners then propounded the following question:

"Q. In inventorying securities, as the partnership did, did the partnership rely on the ruling made in about 1922 as respects the right of a trader in securities to inventory them?"

to which question counsel for respondent objected "as calling for a conclusion." The objection was overruled, and exception noted.

The said ruling referred to in the question above quoted had previously been brought to the attention of the witness, and marked "Petitioners' Exhibit 2 for Identification", and is hereto annexed.

The witness further testified that it was essential for the partnership to inventory its securities in its trading accounts in order to get a true picture of their profit and loss at the end of the year.

Mr. Leonard Schafer, one of the petitioners and a partner of the firm, was a member of the New York Stock Exchange. He was a specialist in certain securities. A specialist receives from other brokers on the Exchange orders at fixed prices (viz., other than at market), for which the specialist keeps orders to buy and sell on his "Specialist Book" at the various limits at which they are placed.

The securities in the "Error Account," which are listed in Exhibits B and C of the stipulation, were not purchased for investment but were purchased for the firm's account with the idea of making a profit.

The witness further testified that participation in the syndicates with respect to the securities shown in Exhibit [fol. 60] 1 would probably imply that the firm had a financial responsibility for a portion of the issue of such securities, and that in selling the same they had agreed to take a certain number of shares at the issue price.

Petitioners offered in evidence a sheet showing the securities in the "Error Account" for the years 1927 and 1928, the prices at which they were sold, the prices at which they were inventoried, and the cost. Said sheet also showed the difference in profits as a result of inventorying those securities in said two years. Objection to the introduction of said sheet as being immaterial was sustained, exception noted, and allowed, and the sheet marked as Petitioners' Exhibit 3 for Identification, hereto annexed.

The securities in the "Error Account" and in any similar account were taken up in the income tax return of the partnership on the basis of market for each of the years 1925, 1926, 1927, 1928 and 1929.

On cross-examination, the witness gave the names of a number of customers of the partnership engaged in vari-

ous occupations but who were not stockbrokers. The firm executed orders for the persons so named by a broker, either the partnership broker or some other broker. The firm did not know the identity of the ultimate purchaser of stocks that were sold to such customers.

The witness described the firm's dealing account as referring to the securities that they bought and sold. Such securities in the "Error Account" were largely securities bought and sold on the floor of the New York Stock Exchange by some other brokers, the firm not knowing the identity of the seller. The witness stated that, in his mind, a dealing account and a trading account were substantially the same.

He was asked whether the firm of Schafer Brothers, in 1929, was listed as specialists. He stated he did not think so, but he stated that certain individual brokers might be so listed. He did not know how the firm was considered on the Stock Exchange but that the firm had a partner (Leonard Schafer) who was a specialist.

He did not believe that it was possible for a partnership to be listed as a specialist although a member or one of the members may specialize. It might be possible for a partnership to do nothing else but specialize.

[fol. 61] Interrogated in regard to the meaning of an investment account, the witness testified:

"A. 'Investment', in my opinion is something that is bought for investment purposes, to be retained for a period of years, period of time, according to its investment qualities.

Q. Was it a speculative account?

A. Well, that is pretty difficult to determine. I don't know exactly just where you draw the line on speculation. I suppose any business where a man buys something at a price with the intention or with the hope of realizing a profit, might possibly be considered speculative. With us, it was a trading proposition."

The securities carried in the "Error Account" were purchased and sold on the floor of whatever exchange they might be listed on, mainly the New York Stock Exchange.

He testified on redirect examination that the securities listed in the "Error Account" were dealt in or traded in either on the floor of the New York Stock Exchange, the Curb, or whatever market they might have been listed on.

CHARLES W. FOUS, called as a witness by the petitioners, testified that he was the bookkeeper of Schafer Brothers and had been a bookkeeper for seven years.

He had examined the books and stated that in 1929 in the "Error Account" there were purchased 107,500 shares of stock and sold 92,500 shares, comprising 72 different varieties of securities.

Of the securities listed in Exhibit B to the stipulation as being on hand in the "Error Account" on December 31, 1928, all except 6 items were sold during 1929, and 9,800 shares were sold.

Of the securities listed in Exhibit C to the stipulation as being on hand in the "Error Account" on December 31, 1929, all of the securities were sold during 1930 excepting 500 shares New York Transportation and 38 shares Tidal Osage. 1,000 shares South American Gold and Platinum, so listed, were sold but the witness was not certain whether in 1930 or 1931.

[fol. 62] EDWARD SCHAFER, one of the petitioners, testified as follows in behalf of the petitioners:

"Q. Will you state what, in the nature of your business, concluded you to inventory your securities in your trading account in 1924, and years thereafter? . . .

A. In 1924, or prior to that, we were taking our inventory at cost, but by doing so we did not know where we stood. After that, we inventoried in order to find out exactly what profit or loss there may have been, in order to divide it amongst the partners. Frankly, anybody that does not inventory his books, does not know what he is saying, or is broke. The New York Stock Exchange insists upon us inventorying our securities, when they require a questionnaire from all the members."

The Stock Exchange requirement that member firms inventory their securities existed in all the years commencing in about 1923 through 1929 and thereafter. If the market were up, a man who did not inventory his securities could conceal his profits.

The partnership paid Federal income taxes on the basis of inventorying securities owned by the firm in 1927. Objec-

tion was sustained and exception noted to the following question:

"Q. Do you know whether in 1927 the profits you reported to the Federal government, on which you paid income tax, were or were not correct, as a result of inventorying?"

The securities held by the partnership at the end of 1929 were not bought for investment, and had the partnership been able to get out with a profit or a small loss, they would have done so. They subsequently sold substantially all of the securities in that account.

He testified on cross-examination that the method of purchasing the securities in the "Error Account" would be for a member of the partnership to give an order to buy the stock to its broker on the floor, who might have been his brother Leonard, or any other broker, and if the stock went higher they would try to take a profit.

The witness did not know the identity of the person who sold to the partnership, other than the broker, and when they sold the securities they would not know the identity of the purchaser, other than the broker.

[fol. 62] The witness testified as follows on direct examination:

"Schafer Brothers has been down in the Street for 73 years, and this is the first time that any one of us has ever been on the stand. We have established losses for everybody that had a loss and that could establish a loss honorably and saved their income tax by doing so. Had I known that the Government was going back—going back on me—I am going to talk freely here, if I can—had I known that the Government was going back on me and tell me, after I was doing a certain thing for ten years, or approximately ten years, that I would have to stop it, and go back and change the idea of what I had been doing for ten years, I would not have been foolish enough to come up here and be asked by you gentlemen at all. I would have sold out these securities, and I would have had no tax to pay. I would not have had this argument with my friends here. I would have been absolutely concluded. There would not have been anything more said about it. I could have bought them back if I felt like it. But I thought the Gov-

ernment's ruling was a ruling. I did not think they were going to change every minute or so, and say 'two years ago you had certain information and you should not have done it'—if they had told me that, I would have sold out my securities, and would have taken a loss."

WILLIAM F. CORNELL, having been recalled as a witness in behalf of the petitioners, was shown copies of the Federal income tax returns of each of the petitioners, Algernon S. Schafer, Edward Schafer and Leonard Schafer, for the calendar year 1927, and sheets containing computations showing what the amount of the Federal income tax of each of said petitioners would have been had the securities of the partnership on hand at the beginning and end of that year been taken at cost in lieu of at market.

Objections to said offers were sustained and exceptions noted and said documents marked for identification as Petitioners' Exhibits 4, 5, 6, 7, 8, and 9, of which copies are hereto annexed.

The Respondent called no witnesses but introduced in evidence the original partnership return for the calendar [fol. 64] year 1929 of Schafer Brothers, 120 Broadway, New York, N. Y., which is hereto annexed as Respondent's Exhibit "A":

The Respondent then called MR. EDWARD SCHAFER as a witness for the Respondent. He was shown his individual income tax return for the calendar year 1929 and stated that the use of the word "broker," after the word "occupation," correctly reflected his occupation in 1929.

On cross-examination by counsel for petitioners, he testified:

"A. I mean by the word 'broker' that I would be buying and selling and dealing in securities, and when we underwrote an issue and obligated ourselves to a certain number of shares, why, we disposed of it to certain clients; or, that if I had bought the stock on the New York Stock Exchange for customers, and sold that out again, that also would come in that."

The following question was then propounded by counsel for petitioners upon cross-examination of the witness:

"Q. You may tell us whether your trading as shown in the error account was merely spasmodic, or was an essential part of your business?"

to which question counsel for respondent objected on the ground that it was not proper cross-examination. The objection being overruled and exception noted, the witness answered that such trading was an essential part of the business of Schafer Brothers in 1929 and for fifty years before.

It is hereby stipulated and agreed that the above and foregoing statement of evidence contains all of the evidence introduced before the United States Board of Tax Appeals material to a consideration of the assignments of error set forth in the petition of petitioners to the Court of Appeals of the District of Columbia for a review of the decision entered herein by the United States Board of Tax Appeals.

It is further stipulated and agreed that said statement, as made, may be approved by the United States Board of Tax Appeals without further notice to either party hereto and, when so approved, said statement of evidence may be [fol. 65] filed in the Clerk's office and may become a part of the record for the purpose of the petition for review filed herein by Algernon S. Schafer, Edward Schafer and Leonard Schafer in this consolidated cause.

Dated August 6, 1935.

Algernon S. Schafer, Edward Schafer, Leonard Schafer, Petitioners, by Eugene Untermyer, Their Attorney. Guy T. Helvering, Commissioner of Internal Revenue, Respondent, by Robert H. Jackson, Assistant General Counsel.

ORDER APPROVING STATEMENT OF EVIDENCE

The foregoing statement on the petition for review of Algernon S. Schafer, Edward Schafer and Leonard Schafer in this consolidated cause is hereby approved, signed and ordered to be made of record in the above entitled cause this 7th day of Aug., 1935.

(S.) Eugene Black, Member of United States Board of Tax Appeals.

Form 1065
TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE

(Auditor's Stamp)

FIELD AUDIT

PARTNERSHIP RETURN OF INCOME

For Calendar Year 1929

File This Return With the Collector of Internal Revenue for Your District on or Before March 15, 1930

PRINT PLAINLY NAME AND BUSINESS ADDRESS OF PARTNERSHIP

Name: Schafer Bros
(Name)
120 Broadway
(Street and Number)
NY NY
(Post Office and State)

Kind of Business: Brokerage

Date of Organization: January 1918

Do Not Write in These Spaces

File Code: 2541
378051

Serial Number:

COLLECTOR (Date Received) MAR 15 1930 2nd DIST. N.Y. INTERNAL REVENUE

Cerified
As 2 —

Item and Instruction No.

GROSS INCOME

1. Gross Receipts from Business or Profession		$ 1104937
2. Less Cost of Goods Sold:		
(a) Inventory at beginning of year		
(b) Merchandise bought for sale		
(c) Cost of labor, supplies, etc. (From Schedule A)	7697783	
(d) Total of Lines (a), (b), and (c)	7697783	
(e) Less inventory at end of year		7697783
3. Gross Profit from Business or Profession (Item 1 minus Item 2)		$ 6512154
4. Income from Other Partnerships. (State name and address)		72270
5. Interest on Bank Deposits, Notes, Corporation Bonds, etc. (except interest on tax-free covenant bonds)		
6. Interest on Tax-free Covenant Bonds upon which a Tax was Paid at Source		
7. Rents		
8. Royalties		
9. Profit from Sale of Real Estate, Stocks, Bonds, etc. (From Schedule B)		
10. Dividends on Stock of Domestic Corporations		3415153
11. Other Income (including dividends on stock of foreign corporations). (State nature of income)		
12. TOTAL INCOME IN ITEMS 3 TO 11		$ 3617193

U.S. BOARD OF TAX APPEALS
DIV. 5 DOCKET 72373
RECEIVED IN EVIDENCE
FEB 28 1934
PETITIONER'S
EXHIBIT A
RESPONDENT'S

DEDUCTIONS

13. Salaries of Employees. (Do not include compensation for partners)		$ 1311486
14. Rent on Business Property		
15. Repairs. (From Schedule D)		
16. Interest on Indebtedness		
17. Taxes on Business Property. (From Schedule E)		
18. Losses by Fire, Storm, etc. (From Schedule F)		
19. Bad Debts. (From Schedule G)		
20. Depreciation, Obsolescence, and Depletion. (From Schedule H)		
21. Other Deductions Authorized by Law. (Explain below or on separate sheet)		
22. TOTAL DEDUCTIONS IN ITEMS 13 TO 21		$ 1311486
23. NET INCOME (Item 12 minus Item 22)		$ 1030579

24.

PARTNERS' SHARES OF INCOME AND CREDITS
(See Instruction 24)

1. NAME AND ADDRESS OF EACH PARTNER	3. DIVIDENDS (ITEM 10 ABOVE)	4. EARNED INCOME	5. BALANCE OF NET INCOME (ITEM 23 MINUS SUM OF AMOUNTS IN COLUMNS 3 AND 4)	6. CAPITAL GAIN OR (SCHEDULE H COLUMN 6) NET LOSS (—)	8. INCOME TAX PAID AT SOURCE (3% OF ITEM 4)	9. INCOME TAX PAID FOREIGN COUNTRIES OR UNITED STATES POSSESSIONS
(a)						
(b) Edward A Schafer	1153185		1173731			
(c)						
(d) Edward A Schafer	1153185		500579			
(e)						
(f) Algernon A. Schafer	1153185		465994			
(g)						
(h)						
(i)						
(j) Totals	3459553		1373231			

R1

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SCHEDULE A—COST OF LABOR, SUPPLIES, ETC. (See Instruction 7)

Items	Amount	Items	Amount (Enter as Item 2c)
Labor Cleaning House 10486 Rent 20784		Stationery + Light 3999 Gardening	12499
Supplies Telephone + Telegram 9611 93		Insurance 3,240.94 Miscellaneous 1,887.50	
Auditing 1400.00 Postage + exp 1399 31			

SCHEDULE B PROFIT FROM SALE OF REAL ESTATE, STOCKS, BONDS, ETC. (See Instruction 9)

1. Kind of Property	2. Date Acquired	3. Amount Received	4. Depreciation Allowable Since Acquisition	5. Cost or Value as of March 1, 1913, Whichever Greater	6. Subsequent Improvements	7. Net Profit (Enter as Item 9)
		$	$	$	$	$

State how property was acquired

SCHEDULE C CAPITAL NET GAIN OR LOSS FROM SALE OF ASSETS HELD MORE THAN TWO YEARS (See Instruction 9a)

1. Kind of Property	2. Date Acquired (Mo. Day Year)	3. Date Sold (Mo. Day Year)	4. Amount Received	5. Depreciation Allowable Since Acquisition	6. Cost or Value as of March 1, 1913, Whichever Greater	7. Subsequent Improvements, and Capital Deductions	8. Net Gain (Enter in Column 8, Item 26 on page 1)
			$	$	$	$	$

State how property was acquired

SCHEDULE D—COST OF REPAIRS (See Instruction 15)

Items	2. Amount (Enter as Item 15)
	$

SCHEDULE E—TAXES PAID (See Instruction 17)

Items	2. Amount (Enter as Item 17)
	$

SCHEDULE F—EXPLANATION OF LOSSES BY FIRE, STORM, ETC. (See Instruction 18)

1. Kind of Property	2. Date Acquired	3. Cost or Value as of March 1, 1913, Whichever Greater	4. Subsequent Improvements	5. Depreciation Allowable Since Acquisition	6. Insurance and Salvage Value	7. Deductible Loss (Enter as Item 18)
		$	$	$	$	$

State how property was acquired

SCHEDULE G—EXPLANATION OF DEDUCTION FOR BAD DEBTS (See Instruction 19)

	Year	Ch'd on Acct.	Bad Debts
(a)	1926	$	$
(b)	1927		
(c)	1928		
(d)	1929		

SCHEDULE H—EXPLANATION OF DEDUCTION FOR DEPRECIATION (See Instruction 20)

1. Kind of Property (If buildings, state material of which constructed)	2. Date Acquired	3. Age When Acquired	4. Probable Life After Acquirement	5. Cost or Value as of March 1, 1913, Whichever Greater (Exclusive of Land)	Amount of Depreciation Charged Off	
					6. Previous years	7. This year
				$	$	$

SCHEDULE I—NONTAXABLE OBLIGATIONS, LIBERTY BONDS, ETC. (See Instruction 24)

1. Obligations or Securities	2. Amount Owned	3. Interest Received
(a) Obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia	$	$
(b) Securities issued under the provisions of the Federal Farm Loan Act, or under such Act as amended, and Certificates of Indebtedness issued after June 17, 1929		
(c) Liberty 3½% Bonds and other obligations of U. S. issued before September 1, 1917, and obligations of U. S. possessions		
(d) Liberty 4% and 4½% Bonds, Certificates of Indebtedness issued before June 18, 1929, Treasury Bonds, and Treasury Savings Certificates		
(e) Treasury Notes		

AFFIDAVIT

I swear (or affirm) that this return, including the accompanying schedules and statements, has been examined by me, and, to the best of my knowledge and belief, is a true and complete return made in good faith for the accounting period stated, pursuant to the Revenue Act of 1928 and the Regulations issued thereunder.

Sworn to and subscribed before me this 14 day of March, 1930.

Michael Bennett
(Signature of officer administering oath)

(Title)

M F Connell
(Member of partnership)

120 Brooding N.Y.A
(Address of partner)

(An amended return must be plainly marked "Amended" across face of return)

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65b

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EXHIBIT 1

		Shares.
1926	Berlin Electric Rway 6½	$15,000
	Financial & Industrial, Cr. "A"	700
	" " " Cr. Pfd.	700
1927 and 1928	Prudence Co. Pfd.	500
	American Stores Co.	300
	Alraham & Stram 5½ Bonds	$15,000
	Associated Rayon Corp.	1,000
	Austrian Credit Instaldt	500
	Buzza Clark Co. com.	1,500
	" " " Pfd.	1,000
	Best Co.	200
	L. Bamburger Co. 6½ Pfd.	500
	[fol. 66] Chain Store Stocks	1,000
	Consolidated Retain Stores	50
	Collem & Aikman	200
	Chi., Auk Island & Par. R. R. 4½	$25,000
	Duplan Siek Corp.	50
	Empire Bond and Mortgage com.	500
	" " " " Pfd.	500
	Felenec Som Wm. Co. com.	150
	" " " " Pfd.	75
	Flankeim Shoe com.	200
	" " Pfd.	100
	Federal Bake Shope	2,500
	S. M. Goldberg Stores com.	5,000
	" " " Pfd.	4,000
	A. C. Gilbert Co. com.	750
	" " " Pfd.	1,500
	Gold Point Hosiery com.	75
	" " " Pfd.	75
	Greek Government 6%	$20,000
	International Safety Razor Co.	200
	International Printing Ink	1,500
	Interstate Dept. Store com.	70
	" " " Pfd.	100
	Joske Bros.	200
	Kroger Grocery & Baking	500
	Keith Aber Orpheim Pfd.	200
	Loews Inc. Pfd.	200
	Mandel Bros.	200
	McKesson & Robbins	1,400

EXHIBIT 1—Continued

		Shares.
	N. Y. Foreign Investing Co. 5½	$20,000
	Webel Oscar com.	2,666⅔
	" " Pfd.	8,000
	Pet Miek Co.	150
	Peoples Drug Store	500
	Second General American Investors	150
	Seiman Bros.	3,500
	St. Louis & San Francisco R. R.	$50,000
	Shulte United Stores com.	600
	" " " Pfd.	600
	Seton Leather Co.	3,000
	Truax Triar Coal Co.	3,500
	Thompson Products Corp.	1,000
	Tishman Realty Co.	300
	[fol. 67] United Biscuit Co. com.	1,200
	United Biscuit Co. Pfd.	300
	United Piece Dyenorke com.	100
	" " " Pfd.	100
	Wayne Peimp Co. com.	2,750
	" " " Pfd.	3,500
	Walgreen Co. com.	500
	" " Pfd.	100
	Woodworth Inc. com.	6,000
	" " Pfd.	6,375
	Westphalia United Electric 6%	$10,000
	Weber & Heillrener Co. Pfd.	100
	Waiti and Bond Co. "A"	12,700
	" " " " "B"	10,675
1929	American International Corp.	$15,000
	Broadway National Bank	1,200
	Blue Ridge Corp. com.	1,500
	" " " Pfd.	1,500
	Commercial Investment Trust 5½	$15,000
	Columbia Picture Corp. com.	3,500
	" " " Pfd.	2,000
	Consolidated Gas Co.	200
	Cream of Wheat Co.	200
	Employers Group Associates	700
	General Realty & Utility	700
	Hahn Dept. Stores com.	300
	" " " Pfd.	300
	Lehman Corp.	1,000

EXHIBIT 1—Continued

	Shares.
Lazarm F. A.	100
National Industrial Service com.	7,550
" " " Pfd.	2,550
Phelps Dodge Co.	500
Stein Cosmetic Co. com.	400
" " " Pfd.	700
Stein A. C. com.	100
" " Pfd.	50
Shenandoah Corp. com.	500
" " Pfd.	500
Tolallo and Allied Stocks	400
United Securities Trust Ass't	2,000
Goldman Sacks Trading	1,250

[fol. 68] PETITIONER'S EXHIBIT #2 FOR IDENTIFICATION

(From Prentice-Hall Tax Service for 1931)

Special Class of Business

Dealers in Securities

9720. Reg. 74, Art. 105. Inventories by dealers in securities.—A dealer in securities, who in his books of account regularly inventories unsold securities on hand either—

(a) At cost;
(b) At cost or market, whichever is lower; or
(c) At market value,

may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the Commissioner. For the purpose of this rule a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities

and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation and not in the course of an established business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule.[1]

[fol. 69] 9724. Individual held to be a dealer in securities. • • • The second question presented by the appeal is whether or not A so conducted his business during the years 1917, 1918, and 1919 as to permit of his classification as a dealer in securities as that term is defined in article 1585 of Regulations 45 (1920 edition), to permit of his inventorying his securities, and using such inventories in computing his taxable net income for each of the said taxable years.

In an affidavit dated October —, 1921, A states:

In 18— I became a member of the Y. Stock Exchange and since that date down to January 1, 1918, and thereafter, have been a dealer in securities upon the Y Stock Exchange as a merchant in securities with an established place of business upon the said stock exchange, regularly engaged in the purchase of securities and their resale to customers, engaged in this business with a view to the gains and profits that may be derived therefrom. The years 1916 and 1917 are fairly representative of my established business upon the Y Stock Exchange. In each of these years I was daily upon the floor of the Exchange transacting my business of dealing in securities. The great bulk of the purchases and sales for my account were made by me individually upon the floor of the Exchange although occasionally an order was given to another member, paying him x dollars per hundred shares, and in and after the

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[1] Omitted: "A dealer in securities is not entitled to the benefits of section 208 with reference to the gain from the sale of securities."

summer of 1917 I ceased being on the floor during the entire session and when not there, handled my orders by telephone from my office to the exchange. All the securities thus purchased were purchased with the purpose and expectation of resale at a profit within a short period of time, and were not purchased in any instance for being held as an investment. In a business of the magnitude of that thus carried on by me it will happen at times that the market does not soon permit a resale at a profit, and wherever stocks have been held by me for a considerable period of time, it has always been because the opportunity of resale at a profit was not presented, and not because of a desire to hold the stocks as an investment. In dealing with millions of shares of stock prior to 1916 there were:

[fol. 70]

		Shares
On hand Dec. 31, 1915		1½ Z
Bought in 1916	24½	
Sold in 1916	23	
Balance of purchases		1½
Bought in 1917	11½	
Sold in 1917	10	
Balance of purchasers		1½
Total of stocks on hand Dec. 31, 1917		4½

All these stocks have subsequently been sold with the exception of ¼ Z shares of two certain stocks, of which there have been no sales for a long time.

The total number of stocks bought or sold in 1916 and 1917 was 69 Z shares. This represents dealings in 130 different kinds of stocks and bonds, counting one $1,000 bond as equivalent to 10 shares of stock. And in making the above balances it is not meant that the identical stocks were carried into the balances which is not the case, but simply that as a result of all the transactions there were the above quantities of different stocks on hand at the above-named dates.

From the evidence submitted it appears to the Committee that the greater portion of the securities purchased by A

during the years in question was acquired solely with a view to a quick turnover at a profit and not for investment purposes. In the affidavit referred to above it is shown that there was purchased in 1916 the equivalent of 24½ z shares of stock of the par value of $100 each (each $1,000 bond being taken as the equivalent of 10 shares of stock each of the par value of $100); that there was sold during the same year the equivalent of 23z shares, leaving the equivalent of 1½z shares on hand at the close of that year, or but 6.41 per cent plus of the total number of shares purchased. At the close of 1917 there remained on hand of the number of shares purchased during that year but 1½z shares, or but 14.2 per cent of the total number of shares purchased during that year. If the purchases and sales for the said two years are consolidated, it is shown that of a total of 36z shares purchased but 8.91 per cent [fol. 71] remained on hand at the end of that period, and in this connection A's statement that—

It is not meant that the identical stocks were carried into the balances, which is not the case, but simply that as a result of all the transactions there were the above quantities of different stocks on hand at the above-named dates—should be noted. Undoubtedly certain of the securities purchased were carried for considerable periods of time when the market did not permit of profitable sales. It is shown that, among others, two stocks amounting to ¼z shares were so carried. With respect to the first no report has been found in Poor's or Moody's Manual, but such publications show that no dividends have been paid upon the latter stock for some years, and therefore it can not be said that such stock was being held for investment purposes. In carrying securities for which there is no demand over from one trade year to another A acted no differently than would a merchant who carries over and includes in his opening inventory of one year goods which were purchased during the preceding year for which no demand resulted.

* * * * * * *

The records in the case show that A has been a member of the Y Stock Exchange since 18— and a member of the stock-exchange firm of M Company. As a member of the said firm A was regularly engaged in the purchase and sale of securities on the floor of the Y Stock Exchange for the

firm's customers and also for his own personal account, although it may be said that inasmuch as the greater portion of the purchases and sales made on his own account was put through the firm of M Company, A as a member of that firm acted for and in behalf of the said firm in purchasing and selling securities for A, one of its customers. It is claimed that at the place of business of M Company there was set aside a room for A's exclusive personal use and that this was considered his own established place of business and was used as such in directing the purchases and sale of securities on his own account and for the purpose of dealing in certain other commodities, it being stated that A is a member of the O Exchange and regularly deals in commodities handled in the O Exchange.

[fol. 72] In the opinion of the Committee the fact that A made the greater portion of his purchases and sales of securities through the agency of the M Company and did not make direct purchases of securities and direct sales to customers from a stock on hand, should not, in itself, preclude his classification as a dealer or merchant of securities. The term "merchant", as defined in Webster's New International Dictionary, includes "any one making a business of buying and selling commodities," "a trafficker," "trader." or "one who traffics on a large scale." It is not to be doubted that A trafficked on a large scale in securities dur- the years 1917, 1918 and 1919; that he was regularly engaged in the purchase and resale of securities for his own account either directly or through the agency of a brokerage firm with a view to the gains and profits to be derived therefrom; that he devoted a considerable portion of his time and attention to such transactions outside of the time and attention he devoted to similar transactions for and in behalf of the firm of the M Company and that the greater portion of the securities so purchased on his own account was not acquired for the purpose of deriving interest or dividends therefrom but for quick and profitable resales.

* * * * * * *

Judging from the records in the case it is not to be doubted that the time and attention devoted by A to the purchase and resale of securities were sufficient to constitute a trade or business, and it is the opinion of the Com-

mittee that if the statements appearing in his affidavit are true, and they have not been controverted in any way, the way and manner in which A traded in securities and the volume of business so transacted were such as to make necessary the inventorying of such securities at the close of each year in order to accurately determine what his net income from such trade or business was for each of the years in question.

* * * * * * *

It is further recommended that the action of the Income Tax Unit in holding that A was not, during the years 1917, 1918, and 1919, a dealer in securities and entitled to inven- [fol. 73] tory his securities at "cost or market whichever is lower" for purposes of Federal Income Tax, be reversed, and that he be classed as a dealer in securities and permitted to use inventories in computing the amount of his taxable net income for each of the years in question, there being excluded from such inventories such securities issued by the United States Government as it is admitted were purchased and held as an investment and not for purposes of resale. (A. R. R. 755, C. B. June, 1922, p. 225).

[fol. 74]

PETITIONER'S EXHIBIT #3 FOR IDENTIFICATION.

1927.

Inventory 12/31/27 Cost or Mkt.	Market 12/31/27.
$395,547.50	$384,584
384,584.	
10,963.50	

Error.

	Sold in 1928.	Inventoried at.	Cost.
200 Foundation	$9,792	$10,000	$20,550
600 Waitl Bond "A"	15,401	15,000	14,100
500 Eastman K	83,292.50	82,000	85,075
1,000 Continental Oil	21,746	20,000	22,000
1,000 Remington Rand	27,360	24,500	24,625
200 Rutland Pf	12,792	11,400	11,800
200 Oppenheim	16,392	16,000	15,200
1,000 Int. Tel. & Tel	146,160	148,000	147,925
500 Erie	32,042.50	32,500	31,812.50
	$364,978	$359,400	$373,087.50
	359,400		364,978
	5,578		8,109.50

[fol. 75]

1928.

Inventory Cost or Mkt. 12/31/28.	Market 12/31/28.		Sold in 1929.	Inventoried at.	Cost.
$328,121.50	$298,732	300 Woodworth Pf	$12,543	$11,700	$11,100
298,732.		1,500 Fansteel	36,040	18,000	22,687.50
		3,000 Remington Rand	99,680	90,000	86,712.50
29,389.50		3,000 Brown Boveri	62,880	48,000	49,525
		2,000 Ca Marconi	16,961.70	18,000	17,375
			$228,104.70	$185,700	$187,400
			185,700		
			42,404.70		
			228,104.70		
			187,400		
			40,704.70		

Securities sold in 1927 which were inventoried in 1926 we showed profit of $35,091.50
If they had not been inventoried we would have shown loss of 3,336

Stocks inventoried end of 1927 we took loss of $38,427.50
10,963.50

$27,464

(Here follow photolithographs of side folios 75a and 75b)

Form 1040
U. S. Internal Revenue

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RETAIN AND OBTAIN
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THE INSTRUCTIONS

INDIVIDUAL INCOME TAX RETURN

FOR NET INCOMES FROM SALARIES OR WAGES OF MORE THAN $5,000
OR INCOMES, INCLUDING OF AMOUNT, FROM BUSINESS, PROFESSION, RENTS, OR SALE OF PROPERTY

For Calendar Year 1927

File This Return With the Collector of Internal Revenue for Your District on or Before March 15, 1928

(PRINT NAME AND ADDRESS PLAINLY BELOW)

EDWARD SCHAFER
(Name)

120 BROADWAY
(Street and number, or rural route)

NEW YORK (Post office) NY (County) (State)

Occupation, Profession, or Business BROKER

DUPLICATE

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IF YOU NEED ASSISTANCE, GO TO DEPUTY COLLECTOR OR TO THE COLLECTOR'S OFFICE

1. Are you a citizen or resident of the United States? citizen
2. If you filed a return for 1926, to what Collector's office was it sent? 2ND DIST N.Y.
3. Is this a joint return of husband and wife? No
4. State name of husband or wife if a separate return was made and the Collector's office where it was sent MILDRED SCHAFER
5. Were you married and living with husband or wife on the last day of your taxable year? YES
6. If not, were you on the last day of your taxable year supporting one or more persons living in your household who are closely related to you? —
7. If your status in respect to questions 5 and 6 changed during the year, state date and nature of change —
8. How many dependent persons (other than husband or wife) under 18 years of age or incapable of self-support because mentally or physically defective were receiving their chief support from you on the last day of your taxable year? 2

Item No.	INCOME	Amount received	Expenses paid (Explain in Schedule F)		
1.	Salaries, Wages, Commissions, etc. (State name and address of person from whom received) SCHAFER BROS	$ 2500	$	$	
	PERFECT WINDOW REGULATOR CORP	1000		3500	—
2.	Income from Business or Profession. (Form Schedule A)				
3.	Interest on Bank Deposits, Notes, Corporation Bonds, etc. (except interest upon which a tax was paid at source)			15	901 56
	(a) Interest on Tax-free Covenant Bonds Upon Which a Tax was Paid at Source				
4.	Income from Partnerships. (State name and address) SCHAFER BROS - 120 BROADWAY NY CITY			45	662 09
	(a) Income from Fiduciaries. (State name and address) ESTATE SAML M SCHAFER - C/O SCHAFER BROS 120 BROADWAY NY CITY				477 15
5.	Rents and Royalties. (From Schedule B)				
6.	Profit from Sale of Real Estate, Stocks, Bonds, etc. (From Schedule C)			24	835 70
7.	Dividends on Stock of Domestic Corporations FROM PARTNERSHIP SCHAFER BROS $365 00 Jan '27 $730 00			15	494 03
8.	Taxable Interest on Liberty Bonds, etc. (From Schedule E)				
9.	Other Income (including dividends received on stock of foreign corporations). (State nature of income)				
	(a)				

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Nos. 6549 - 50 - 51
Schafer v. Helvering

U.S. Internal Revenue

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RETAIN AND OBTAIN FOR COPY OF THE INSTRUCTIONS

INDIVIDUAL INCOME TAX RETURN

FOR NET INCOMES FROM SALARIES OR WAGES OF MORE THAN $5,000 OR INCOMES, REGARDLESS OF AMOUNT, FROM BUSINESS, PROFESSION, RENTS, OR SALE OF PROPERTY

For Calendar Year 1927

File This Return With the Collector of Internal Revenue for Your District on or Before March 15, 1928

(PRINT NAME AND ADDRESS PLAINLY BELOW)

EDWARD SCHAFER (Name)

120 BROADWAY (Street and number, or rural route)

NEW YORK (Post office) NY (County) (State)

Occupation, Profession, or Business BROKER

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IF YOU NEED ASSISTANCE, GO TO DEPUTY COLLECTOR OR TO THE COLLECTOR'S OFFICE

1. Are you a citizen or resident of the United States? citizen
2. If you filed a return for 1926, to what Collector's office was it sent? 2ND DIST NY.
3. Is this a joint return of husband and wife? No
4. State name of husband or wife if a separate return was made and the Collector's office where it was sent MILDRED SCHAFER
5. Were you married and living with husband or wife on the last day of your taxable year? YES
6. If not, were you on the last day of your taxable year supporting one or more persons living in your household who are closely related to you? —
7. If your status in respect to questions 5 and 6 changed during the year, state date and nature of change —
8. How many dependent persons (other than husband or wife) under 18 years of age or incapable of self-support because mentally or physically defective were receiving their chief support from you on the last day of your taxable year? 2

INCOME

	Amount received	Deduct amount shown in Schedule F	
1. Salaries, Wages, Commissions, etc. (State name and address of person from whom received) SCHAFER BROS	$ 2500	$	
PERFECT WINDOW REGULATOR CORP	1000		3500 —
2. Income from Business or Profession. (From Schedule A)			
3. Interest on Bank Deposits, Notes, Corporation Bonds, etc. (except interest upon which a tax was paid at source)			15 901 56
(a) Interest on Tax-free Covenant Bonds Upon Which a Tax was Paid at Source			
4. Income from Partnerships. (State name and address) SCHAFER BROS - 120 BROADWAY NY CITY			45 662 09
(a) Income from Fiduciaries. (State name and address) ESTATE SAML M SCHAFER - C/O SCHAFER BROS 120 BROADWAY NY CITY			477 15
5. Rents and Royalties. (From Schedule B)			
6. Profit from Sale of Real Estate, Stocks, Bonds, etc. (From Schedule C)			74 835 70
7. Dividends on Stock of Domestic Corporations FROM PARTNERSHIP SCHAFER BROS $5365.00 less $715.00			15 495 03
8. Taxable Interest on Liberty Bonds, etc. (From Schedule E)			
9. Other Income (including dividends received on stock of foreign corporations). (State nature of income)			
(a)			
(b)			
10. TOTAL INCOME IN ITEMS 1 TO 9			$ 151 979 53

DEDUCTIONS

11. Interest Paid	$ 8011 56	
12. Taxes Paid. (Explain in Schedule F)	6492 16	
13. Losses by Fire, Storm, etc. (Explain in Table on page 2)		
14. Bad Debts. (Explain in Schedule F)		
15. Contributions. (Explain in Schedule F)	5275	
16. Other Deductions Authorized by Law. (Explain in Schedule F)		
17. TOTAL DEDUCTIONS IN ITEMS 11 TO 16		$ 10 778 72
18. NET INCOME (Item 10 minus Item 17)		$ 136 100 81

COMPUTATION OF TAX (See Instruction 21)

19. Earned Net Income (not over $20,000)	$ 24 000	00	31. Net Income (Item 18 above)	$ 136 100	81	42. Normal Tax (1½% of Item 36)	$ 60
20. Less Personal Exemption and Credit for Dependents (see Instruction 20)	43 00		32. Less Dividends (Item 7 above)	$ 15 495 03		43. Normal Tax (3% of Item 40)	120
21. Balance (Item 19 minus 20)	$ 15700	00	33. Interest on Liberty Bonds, etc. (Item 8)	—		44. Normal Tax (6% of Item 41)	5416 29
22. Amount taxable at 1½% (not over the first $4,000 of Item 21)	$ 4000	—	34. Personal Exemption	3500		45. Surtax on Item 18 (see Instruction 21)	1888 16
23. Amount taxable at 3% (not over the second $4,000 of Item 21)	4000	—	35. Credit for Dependents	800		46. Tax on Net Income (total of Items 42, 43, 44, and 45)	$ 7484 45
24. Amount taxable at 5% (balance over $8,000 of Item 21)	7700	—	36. Total of Items 32, 33, 34, and 35	19795	03	47. Less Credit of 25% of Tax on Earned Net Income (Item 30)	196 25
25. Normal Tax (1½% of Item 22)	$ 60		37. Balance (Item 31 minus 36)	$ 116305	78	48. Balance (Item 46 minus 47)	$ 7288 20
26. Normal Tax (3% of Item 23)	120		38. Amount taxable at 1½% (not over the first $4,000 of Item 37)	4000	—	49. Adjustment for Capital Gain or Loss (12½% of Column 9, Schedule D)	655 84
27. Normal Tax (5% of Item 24)	385		39. Balance (Item 37 minus 38)	$ 112305	78	50. Total Tax (total of or difference between Items 48 and 49)	$ 7944 04
28. Surtax on Item 19 (see Instruction 21)	330		40. Amount taxable at 3% (not over the second $4,000 of Item 37)	4000	—	51. Less Income Tax Paid at Source	—
29. Tax on Earned Net Income (total of Items 25, 26, 27, and 28)	$ 895		41. Amount taxable at 5% (balance over $8,000 of Item 37)	$ 108305	78	52. Income and Profits Taxes paid to a foreign country or U. S. possession	—
30. Credit of 25% of Item 29 (not over 25% of Items 26, 42, 43, and 44)	$ 1962	5				53. Balance of Tax (Item 50 minus Items 51 and 52)	$ 7944 04

TAXPAYER'S RECORD OF PAYMENTS

PAYMENT	AMOUNT	DATE	CHECK OR M. O. NO.	BANK OR OFFICE OF ISSUE
First				
Second				
Third				
Fourth				

An amended return must be marked "Amended" at top of return

Checks and drafts will be accepted only if payable at par

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FEB 28

Nos. 6549 - 50 - 51
Schafer v. Helvering

75a

SCHEDULE A—INCOME FROM BUSINESS OR PROFESSION (See Instructions 4)

1. Total receipts from business or profession (state kind of business)

Cost of Goods Sold		Other Business Deductions	
2. Labor		10. Salaries, exclusive of "Labor," reported on Line 2, and exclusive of compensation for your services	
3. Material and supplies		11. Interest on business indebtedness to others	
4. Merchandise bought for sale		12. Taxes on business and business property	
5. Other costs (Itemize below or on separate sheet)		13. Losses by fire, storm, etc. (explain in table provided therefor at foot of page)	
6. Plus inventory at beginning of year		14. Bad debts arising from sales or services	
7. Total (Lines 2 to 6, inclusive)		15. Depreciation, obsolescence, and depletion (explain in table provided therefor at foot of page)	
8. Less inventory at end of year		16. Rent, repairs, and other expenses (itemized below or on separate sheet)	
9. Net Cost of Goods Sold (Line 7 minus Line 8)		17. Total (Lines 10 to 16, inclusive)	
		18. Total Deductions (Line 9 plus Line 17)	
		19. Net Profit (Line 1 minus Line 18) (Enter as Item 2)	

Note.—Do not deduct here or elsewhere compensation for your services.

Explanation of deductions claimed on Lines 5 and 16

SCHEDULE B—INCOME FROM RENTS AND ROYALTIES (See Instruction 5)

1. Kind of Property	2. Amount Received	3. Cost	4. Value as of March 1, 1913	5. Depreciation (Explain in table at foot of page)	6. Repairs	7. Other Expenses (Itemize below)	8. Net Profit (Enter as Item 4)

Explanation of deductions claimed in Column 7

SCHEDULE C—PROFIT FROM SALE OF REAL ESTATE, STOCKS, BONDS, ETC. (See Instruction 6)

1. Kind of Property	2. Date Acquired	3. Amount Received	4. Depreciation Allowable Since Acquisition	5. Cost	6. Value as of March 1, 1913	7. Subsequent Improvements	8. Net Profit (Enter as Item 6)
Annuities	1927	$ 246.61	—	$ 3,383.31	7	—	$ 7.83
Maturity of trading							

State how property was acquired

SCHEDULE D—CAPITAL NET GAIN OR LOSS FROM SALE OF ASSETS HELD MORE THAN TWO YEARS (See Instruction 6a)

1. Kind of Property	2. Date Acquired (Mo. Day Year)	3. Date Sold (Mo. Day Year)	4. Amount Received	5. Depreciation Allowable Since Acquisition	6. Cost	7. Value as of March 1, 1913	8. Subsequent Improvements and Capital Deductions	9. Net Gain or Loss (Enter 1/2 of Item 6)
Baby Vanadium Mines Stock	July 19 27	May 24 27	$ 11.27	—	$ 6.24 31	—	—	$ 2.46 69

State how property was acquired

SCHEDULE E—INTEREST ON LIBERTY BONDS AND OTHER OBLIGATIONS OR SECURITIES (See Instruction 8)

1. Obligations or Securities	2. Interest Received or Accrued	3. Amount Owned	4. Total Amount Exempt From Taxation	5. Amount Owned in Excess of Exemption	6. Interest on Amount in Excess of Exemption (Enter as Item 8)
(a) Obligations of a State, Territory, or political subdivision thereof, or the District of Columbia			All	XXXXXX XX	XXXXXX XX
(b) Securities issued under Federal Farm Loan Act, or under such Act as Amended			All	XXXXXX XX	XXXXXX XX
(c) Liberty 3½% Bonds and other obligations of United States issued on or before September 1, 1917, and obligations of possessions of the United States			All	XXXXXX XX	XXXXXX XX
(d) Liberty 4% and 4½% Bonds, Treasury 3½%, 3¾%, 4%, and 4¼% Bonds, Treasury Certificates of Indebtedness, and Treasury (War) Savings Certificates			$5,000		
(e) Treasury Notes			None		

SCHEDULE F—EXPLANATION OF DEDUCTIONS CLAIMED IN ITEMS 1, 12, 14, 15, AND 16

Federal Jewish Charities	165.
Temple Emanuel	50.
Dr.	500.
Hudson Guild	10.
Long Beach Hospital	50.
	275.

EXPLANATION OF DEDUCTION FOR DEPRECIATION CLAIMED IN SCHEDULES A AND B

1. Kind of Property (If buildings, state material of which constructed)	2. Date Acquired	3. Cost or Other Basis	4. Previous Depreciation Allowed or Allowable	5. Value (If Discovery of Land)	6. Value as of March 1, 1913 (If Discovery of Land)	Amount of Depreciation Claimed This Year: 7. Previous Years	8. This Year

EXPLANATION OF DEDUCTION FOR LOSSES BY FIRE, STORM, ETC., CLAIMED IN SCHEDULE A, AND IN ITEM 13

1. Kind of Property	2. Date Acquired	3. Cost or Other Basis	4. Depreciation Allowed or Allowable Since Acquisition	5. Value (If Discovery of Land)	6. Insurance Received	7. Insurance and Salvage Value	8. Deductible Loss

Hos. 6549 - 50 - 51
Schafer v. Helvering

750

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[fol. 76] PETITIONER'S EXHIBIT #5 FOR IDENTIFICATION

E. S.—1927

3/27,464		$136,100.81
9,154.66		9,154.66
	Item 18	126,946.15
	Less exemptions	19,795.03
		107,151.12
	Item 38	4,000.00
		103,151.12
	Item 40	4,000.00
	Item 41	99,151.12
Item 42—1½%		$60.00
" 43—3%		120.00
" 44—5%		4,957.56
" 45—surtax		17,049.23
		22,186.79
" 47—Less credits		196.25
		21,990.54
" 49—Capital gain		655.84
" 53		$22,646.38
Tax paid	$24,935.04	equals difference of 25% on $9,154.66—5% on normal, 20% on surtax.
Would have paid	22,646.38	
Excess	$2,288.66	
100,000 @ 19		$11,660.00
26,946.15 @ 20		5,389.23
		$17,049.23

[fol. 77]

E. S. paid normal tax 5%	$5,415.29	
Would have paid	4,959.56	
	457.73	$457.73
Paid surtax	18,880.16	
Would have paid	17,049.23	
	1,830.93	1,830.93
		$2,288.66

(Here follow photolithographs of side folios 77a and 77b)

Form 1040
INTERNAL REVENUE

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DETACH AND RETAIN THIS COPY AND THE INSTRUCTIONS

INDIVIDUAL INCOME TAX RETURN

FOR NET INCOMES FROM SALARIES OR WAGES OF MORE THAN $5,000
OR INCOMES, REGARDLESS OF AMOUNT, FROM BUSINESS, PROFESSION, RENTS, OR SALE OF PROPERTY

For Calendar Year 1927

File This Return With the Collector of Internal Revenue for Your District on or Before March 15, 1928

DUPLICATE

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IF YOU NEED ASSISTANCE, GO TO A DEPUTY COLLECTOR OR TO THE COLLECTOR'S OFFICE

(PRINT NAME AND ADDRESS PLAINLY BELOW)

LEONARD SCHAFER
(Name)

120 BROADWAY
(Street and Number, or Rural Route)

NEW YORK (Post Office) NY (County) (State)

Occupation, Profession, or Business BROKER

1. Are you a citizen or resident of the United States? CITIZEN
2. If you filed a return for 1926, to what Collector's office was it sent? 2ND DIST NY
3. Is this a joint return of husband and wife? No
4. State name of husband or wife if a separate return was made and the Collector's office where it was sent ADELINA T SCHAFER
5. Were you married and living with husband or wife on the last day of your taxable year? YES
6. If not, were you on the last day of your taxable year supporting one or more persons living in your household who are closely related to you? —
7. If your status in respect to questions 5 and 6 changed during the year, state date and nature of change —
8. How many dependent persons (other than husband or wife) under 18 years of age or incapable of self-support because mentally or physically defective were receiving their chief support from you on the last day of your taxable year? ONE

Item and Instruction No.

INCOME

	Amount received	Expenses paid (Deduct on line 9)	
1. Salaries, Wages, Commissions, etc. (State name and address of person from whom received) SCHAFER BROS 120 BROADWAY NY CITY	$ 5000 00	$ —	$ 5000 00
2. Income from Business or Profession. (From Schedule A)			
3. Interest on Bank Deposits, Notes, Corporation Bonds, etc. (except interest upon which a tax was paid at source)			—
(a) Interest on Tax-free Covenant Bonds Upon Which a Tax was Paid at Source			6437 16
4. Income from Partnerships. (State name and address) SCHAFER BROS - 120 BROADWAY NY CITY			4669 09
(a) Income from Fiduciaries. (State name and address) EST of SAML M SCHAFER - C/O SCHAFER BROS 120 BROADWAY NY CITY			477 15
5. Rents and Royalties. (From Schedule B)			—
6. Profit from Sale of Real Estate, Stocks, Bonds, etc. (From Schedule C)			—

Bos. Schaf

Form 1040
Internal Revenue

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INDIVIDUAL INCOME TAX RETURN

FOR NET INCOMES FROM SALARIES OR WAGES OF MORE THAN $5,000
OR INCOMES, REGARDLESS OF AMOUNT, FROM BUSINESS, PROFESSION, RENTS, OR SALE OF PROPERTY

For Calendar Year 1927

File This Return With the Collector of Internal Revenue for Your District on or Before March 15, 1928

(PRINT NAME AND ADDRESS PLAINLY BELOW)

LEONARD SCHAFER (Name)

120 BROADWAY (Street and number or R.F.D. number)

NEW YORK (Post office) NY (County) (State)

Occupation, Profession, or Business BROKER

DUPLICATE

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IF YOU NEED ASSISTANCE, GO TO A DEPUTY COLLECTOR OR TO THE COLLECTOR'S OFFICE

1. Are you a citizen or resident of the United States? CITIZEN
2. If you filed a return for 1926, to what Collector's office was it sent? 2ND DIST NY
3. Is this a joint return of husband and wife? No
4. State name of husband or wife if a separate return was made and the Collector's office where it was sent ADELINA T SCHAFER
5. Were you married and living with husband or wife on the last day of your taxable year? YES
6. If not, were you on the last day of your taxable year supporting one or more persons living in your household who are closely related to you? —
7. If your status in respect to questions 5 and 6 changed during the year, state date and nature of change —
8. How many dependent persons (other than husband or wife) under 18 years of age or incapable of self-support because mentally or physically defective were receiving their chief support from you on the last day of your taxable year? ONE

INCOME

	Amount received	Exempt and deductions	
1. Salaries, Wages, Commissions, etc. (State name and address of person from whom received) SCHAFER BROS 120 BROADWAY NY CITY	$ 5000	$ —	$ 5000 —
2. Income from Business or Profession. (From Schedule A)			—
3. Interest on Bank Deposits, Notes, Corporation Bonds, etc. (except interest upon which a tax was paid at source)			6427 16
(a) Interest on Tax-free Covenant Bonds Upon Which a Tax was Paid at Source			—
4. Income from Partnerships. (State name and address) SCHAFER BROS - 120 BROADWAY NY CITY			447 69
(a) Income from Fiduciaries. (State name and address) EST of SAML M SCHAFER - % SCHAFER BROS 120 BROADWAY NY CITY			477 15
5. Rents and Royalties. (From Schedule B)			—
6. Profit from Sale of Real Estate, Stocks, Bonds, etc. (From Schedule C)			2923 75
7. Dividends on Stock of Domestic Corporations From PARTNERSHIP - SCHAFER BROS $865.00 - DIVIDENDS $6000			9005 00
8. Taxable Interest on Liberty Bonds, etc. (From Schedule E)			—
9. Other Income (including dividends received on stock of foreign corporations). (State nature of income)			
(a)			
(b)			
10. TOTAL INCOME IN ITEMS 1 TO 9			$ 69506 19

DEDUCTIONS

11. Interest Paid	$ 1109 86	
12. Taxes Paid. (Explain in Schedule F)	3486 07	
13. Losses by Fire, Storm, etc. (Explain in Table on page 2)		
14. Bad Debts. (Explain in Schedule F)		
15. Contributions. (Explain in Schedule F)	49.5	
16. Other Deductions Authorized by Law. (Explain in Schedule F)		
17. TOTAL DEDUCTIONS IN ITEMS 11 TO 16		$ 5090 93
18. NET INCOME (Item 10 minus Item 17)		$ 64415 26

U. S. BOARD OF TAX APPEALS
DIVISION 8B
RECEIVED FOR IDENTIFICATION
FEB 28 1934
PETITIONER'S EXHIBIT 6
DOCKET

COMPUTATION OF TAX (See Instruction 31)

19. Earned Net Income (not over $20,000)	$ 20000	31. Net Income (Item 18 above)	$ 64415 26	43. Normal Tax (1½% of Item 38)	$ 60
20. Less Personal Exemption and Credit for Dependents (see Instruction 20)	4400	32. Less Dividends (Item 7 above)	$ 9005 00	44. Normal Tax (3% of Item 40)	120
21. Balance (Item 19 minus 20)	$ 16100	33. Interest on Liberty Bonds, etc. (Item 8)	—	45. Normal Tax (5% of Item 41)	3125 51
22. Amount taxable at 1½% (not over the first $4,000 of Item 21)	$ 4000	34. Personal Exemption	3500	46. Surtax on Item 18 (see Instruction 32)	5110 58
23. Amount taxable at 3% (not over the second $4,000 of Item 21)	4000	35. Credit for Dependents	400	47. Tax on Net Income (total of Items 42, 43, 44, and 45)	$ 7456 10
24. Amount taxable at 5% (balance over $8,000 of Item 21)	8100	36. Total of Items 32, 33, 34, and 35	12905 00	48. Less Credit of 25% of Tax on Earned Net Income (Item 30)	301 25
25. Normal Tax (1½% of Item 22)	$ 60	37. Balance (Item 31 minus 36)	$ 51510 26	49. Balance (Item 47 minus 48)	$ 7154 85
26. Normal Tax (3% of Item 23)	120	38. Amount taxable at 1½% (not over the first $4,000 of Item 37)	4000	50. Adjustment for Capital Gain or Loss (12½% of Column 5, Schedule D)	—
27. Normal Tax (5% of Item 24)	405	39. Balance (Item 37 minus 38)	$ 47510 26	51. Total Tax (total of or difference between Items 49 and 50)	$ 7154 85
28. Surtax on Item 19 (see Instruction 21)	320	40. Amount taxable at 3% (not over the second $4,000 of Item 37)	4000 —	52. Less Income Tax Paid at Source	—
29. Tax on Earned Net Income (total of Items 25, 26, 27, and 28)	$ 905	41. Amount taxable at 5% (balance over $8,000 of Item 37)	43510 26	53. Income and Profits Taxes paid to a foreign country or U. S. possession	—
30. Credit of 25% of Item 29 (not over 25% of Items 38, 42, 43, and 44)	$ 301 25			54. Balance of Tax (Item 51 minus Items 52 and 53)	$ 7154 85

TAXPAYER'S RECORD OF PAYMENTS

Payment	Amount	Date	Check or M. O. No.	Bank or Collector
First				
Second				
Third				
Fourth				

An amended return must be marked "Amended" at top of return

Checks and drafts will be accepted subject to payment

Nos. 6549 - 50 - 51
Schafer v. Helvering

SCHEDULE A—INCOME FROM BUSINESS OR PROFESSION (See Instruction 2)

1. Total receipts from business or profession (state kind of business) ..... $

Cost of Goods Sold		Other Business Deductions	
2. Labor	$	10. Salaries, exclusive of "Labor," reported on Line 2, and exclusive of compensation for your services	$
3. Material and supplies		11. Interest on business indebtedness to others	
4. Merchandise bought for sale		12. Taxes on business and business property	
5. Other costs (itemize below or on separate sheet)		13. Losses by fire, storm, etc. (explain in table provided therefor at foot of page)	
6. Plus inventory at beginning of year		14. Bad debts arising from sales or services	
7. Total (Lines 2 to 6, inclusive)	$	15. Depreciation, obsolescence, and depletion (explain in table provided therefor at foot of page)	
8. Less inventory at end of year		16. Rent, repairs, and other expenses (itemized below or on separate sheet)	
9. Net Cost of Goods Sold (Line 7 minus Line 8)	$	17. Total (Lines 10 to 16, inclusive)	$
		18. Total Deductions (Line 9 plus Line 17)	$
		19. Net Profit (Line 1 minus Line 18) (Enter as Item 2)	$

Note.—Do not deduct here or elsewhere compensation for your services.

Explanation of deductions claimed on Lines 5 and 16 .....

SCHEDULE B—INCOME FROM RENTS AND ROYALTIES (See Instruction 3)

1. Kind of Property	2. Amount Received	3. Cost	4. Value as of March 1, 1913	5. Depreciation Allowable since March 1, 1913	6. Repairs	7. Other Expenses (Itemize below)	8. Net Profit (Enter as Item 4)
	$	$	$	$	$	$	$

Explanation of deductions claimed in Column 7 .....

SCHEDULE C—PROFIT FROM SALE OF REAL ESTATE, STOCKS, BONDS, ETC. (See Instruction 6)

1. Kind of Property	2. Date Acquired	3. Amount Received	4. Depreciation Allowable since Acquisition	5. Cost	6. Value as of March 1, 1913	7. Subsequent Improvements	8. Net Profit (Enter as Item 6)
Securities	1927	$ 16,000 —	$ —	$ 159,131 25	$ —	$ —	$ 3923 75

State how property was acquired .....

SCHEDULE D—CAPITAL NET GAIN OR LOSS FROM SALE OF ASSETS HELD MORE THAN TWO YEARS (See Instruction 6a)

1. Kind of Property	2. Date Acquired Mo. Day Year	3. Date Sold Mo. Day Year	4. Amount Received	5. Depreciation Allowable since Acquisition	6. Cost	7. Value as of March 1, 1913	8. Subsequent Improvements, and Capital Deductions	9. Net Gain or Loss (Enter Gain or Loss on Item 6)
			$	$	$	$	$	$

State how property was acquired .....

SCHEDULE E—INTEREST ON LIBERTY BONDS AND OTHER OBLIGATIONS OR SECURITIES (See Instruction 8)

1. Obligations or Securities	2. Interest Received or Accrued	3. Amount Owned	4. Principal Amount Exempt from Taxation	5. Amount Owned in Excess of Exemption	6. Interest on Amount in Excess of Exemption (Enter as Item 5)
(a) Obligations of a State, Territory, or political subdivision thereof, or the District of Columbia	$	$	All	XXXXXX XX	XXXXXX XX
(b) Securities issued under Federal Farm Loan Act, or under such Act as Amended			All	XXXXXX XX	XXXXXX XX
(c) Liberty 3½% Bonds and other obligations of United States issued on or before September 1, 1917, and obligations of possessions of the United States			All	XXXXXX XX	XXXXXX XX
(d) Liberty 4% and 4¼% Bonds, Treasury 3½%, 3¾%, 4%, and 4¼% Bonds, Treasury Certificates of Indebtedness, and Treasury (War) Savings Certificates			$5,000	$	$
(e) Treasury Notes			None		

SCHEDULE F—EXPLANATION OF DEDUCTIONS CLAIMED IN ITEMS 1, 12, 14, 15, AND 16

Taxes - Real Estate 1857.62 - Key State Income Tax 1128.43 - Property 500 -

Charity - Brooklyn Federation $40 - Federation Jewish Charities $150 - Neuro Federation $20 - Long Beach Hospital $10
Lake Placid Hospital 2542 American Overseas Fund $50 - Eisenhower Day Nursery 1022
West End Collegiate Church $15 - Irving Institute $10

EXPLANATION OF DEDUCTION FOR DEPRECIATION CLAIMED IN SCHEDULES A AND B

1. Kind of Property (Buildings, state material of which constructed)	2. Date Acquired	3. Age When Acquired	4. Estimated Life After Acquirement	5. Cost (Exclusive of Land)	6. Value as of March 1, 1913 (Exclusive of Land)	Amount of Depreciation Claimed On: 7. Previous years	8. This year
				$	$	$	$

EXPLANATION OF DEDUCTION FOR LOSSES BY FIRE, STORM, ETC., CLAIMED IN SCHEDULE A, AND IN ITEM 13

1. Kind of Property	2. Date Acquired	3. Cost	4. Value as of March 1, 1913	5. Depreciation and Improvements	6. Depreciation Allowable since Acquisition	Insurance and Salvage Value	8. Deductible Loss
		$	$	$	$	$	$

Nos. 6549 - 50 - 51
Schafer V. Helvering

PETITIONER'S EXHIBIT #7 FOR IDENTIFICATION

L. S.—1927

Line 18 and 31—Net income reported	$64,415.26
Dif. Stocks at cost—less	9,154.66
Line 18 and 31, revised	55,260.60
Less exemption	12,905.04
Item 37	42,355.56
" 38	4,000.00
" 39	38,355.56
" 40	4,000.00
" 41	34,355.56
Item 42—1½%	$60.00
" 43—3%	120.00
" 44—5% of Item 41	1,717.78
" 45—Surtax	3,696.48
" 46	5,594.26
" 47—Less credit 25%	201.25
" 48	5,393.01
" 49—Capital gain	0.00
" 53	$5,393.01

[fol. 78]

Tax paid	$7,264.85	17% on $415.36	$70.59
Would have paid	5,393.01	16% on $4,000.00	640.00
		15% on $4,000.00	600.00
Excess	1,871.84	14% on $739.40	103.52
		5% on $9,154.66	457.73
			$1,871.84

$52,000—13%	$3,240.00
$3,260.60—14%	456.48
	$3,696.48

		Dif.
L. S. paid normal tax, 5%	$2,175.51	
Would have paid	1,717.78	
	457.73	457.73
Paid surtax	5,110.59	
Would have paid	3,696.48	
	1,414.11	1,414.11
		$1,871.84

(Here follow photolithographs of side folios 78a and 78b)

Form 1040
U. S. Internal Revenue

DUPLICATE

Copy

DETACH AND RETURN THIS COPY AND THE INSTRUCTIONS

INDIVIDUAL INCOME TAX RETURN

FOR NET INCOMES FROM SALARIES OR WAGES OF MORE THAN $5,000
OR INCOMES, REGARDLESS OF AMOUNT, FROM BUSINESS, PROFESSION, RENTS, OR SALE OF PROPERTY

For Calendar Year 1927

File This Return With the Collector of Internal Revenue for Your District on or Before March 15, 1928

DUPLICATE

Copy

IF YOU NEED ASSISTANCE, GO TO A DEPUTY COLLECTOR OR TO THE COLLECTOR'S OFFICE

(PRINT NAME AND ADDRESS PLAINLY BELOW)

ALGERNON S SCHAFER
(Name)

45 HULLS TERRACE
(Street and number, or rural route)

YONKERS (Post office) NY (County) (State)

Occupation, Profession, or Business BROKER

1. Are you a citizen or resident of the United States? CITIZEN
2. If you filed a return for 1926, to what Collector's office was it sent? ALBANY
   Is this a joint return of husband and wife? No
   State name of husband or wife if a separate return was made and the Collector's office where it was sent IRENE S SCHAFER
3. Were you married and living with husband or wife on the last day of your taxable year? YES
4. If not, were you on the last day of your taxable year supporting one or more persons living in your household who are closely related to you? —
5. If your status in respect to questions 3 and 4 changed during the year, state date and nature of change —
6. How many dependent persons (other than husband or wife) under 18 years of age or incapable of self-support because mentally or physically defective were receiving their chief support from you on the last day of your taxable year? ONE

INCOME

	Amount received	Expenses paid (Required in subdivision 2)	
1. Salaries, Wages, Commissions, etc. (State names and addresses of persons from whom received) SCHAFER BROS 120 BROADWAY NY CITY	$ 5000 —	$ —	$ 5000 —
			—
			—
2. Income from Business or Profession. (From Schedule A)			—
3. Interest on Bank Deposits, Notes, Corporation Bonds, etc. (except interest upon which a tax has been paid at source)			36 90
(a) Interest on Tax-free Covenant Bonds Upon Which a Tax was Paid at Source			—
4. Income from Partnerships. (State names and address) SCHAFER BROS 120 BROADWAY NY CITY			663 09
			—
(a) Income from Estates or Trusts. Estate of Sam M Schafer & Schafer Bros			1332 60

COLLECTOR OF TAX AFFIXES (Initials in ink) FEB 28 1931 EXHIBIT

Form 1040
U. S. Internal Revenue

DUPLICATE

Copy 1

DETACH AND RETURN THIS COPY AND THE INSTRUCTIONS

INDIVIDUAL INCOME TAX RETURN

FOR NET INCOMES FROM SALARIES OR WAGES OF MORE THAN $5,000
OR INCOMES, REGARDLESS OF AMOUNT, FROM BUSINESS, PROFESSION, RENTS, OR SALE OF PROPERTY

For Calendar Year 1927

File This Return With the Collector of Internal Revenue for Your District on or Before March 15, 1928

(PRINT NAME AND ADDRESS PLAINLY BELOW)

ALGERNON S SCHAFER
(Name)

45 HULLS TERRACE
(Street and number, or Rural route)

YONKERS NY
(Post office) (County) (State)

Occupation, Profession, or Business BROKER

DUPLICATE

Copy 1

IF YOU NEED ASSISTANCE, GO TO A DEPUTY COLLECTOR OR TO THE COLLECTOR'S OFFICE

1. Are you a citizen or resident of the United States? CITIZEN
2. If you filed a return for 1926, to what Collector's office was it sent? ALBANY
   Is this a joint return of husband and wife? No
   State name of husband or wife if a separate return was made and the Collector's office where it was sent IRENE S SCHAFER
5. Were you married and living with husband or wife on the last day of your taxable year? YES
6. If not, were you on the last day of your taxable year supporting one or more persons living in your household who are closely related to you? —
7. If your status in respect to questions 5 and 6 changed during the year, state date and nature of change —
8. How many dependent persons (other than husband or wife) under 18 years of age or incapable of self-support because mentally or physically defective were receiving their chief support from you on the last day of your taxable year? ONE

U.S. BOARD OF TAX APPEALS — DIVISION NO. — DOCKET NO. — FEB 28 1931 — FILED — EXHIBIT — RESPONDENT

INCOME		
1. Salaries, Wages, Commissions, etc. (State name and address of person from whom received) SCHAFER BROS 120 BROADWAY NYCITY	$ 5000 —	$ 5000 —
2. Income from Business or Profession. (From Schedule A)		—
3. Interest on Bank Deposits, Notes, Corporation Bonds, etc. (except interest upon which a tax was paid at source)		336 90
(a) Interest on Tax-free Covenant Bonds Upon Which a Tax was Paid at Source		—
4. Income from Partnerships. (State name and address) SCHAFER BROS 120 BROADWAY, NY CITY		45663 09
		—
(a) Income from Fiduciaries. (State name and address) ESTATE OF SAML M SCHAFER - % SCHAFER BROS 120 BROADWAY NYCITY		477 15
5. Rents and Royalties. (From Schedule B)		—
6. Profit from Sale of Real Estate, Stocks, Bonds, etc. (From Schedule C)		6227 35
7. Dividends on Stock of Domestic Corporations SCHAFER BROS 8365 00 DIRECT 640 00		9005 04
8. Taxable Interest on Liberty Bonds, etc. (From Schedule E)		—
9. Other Income (including dividends received on stock of foreign corporations). (State nature of income)		
(a)		—
(b)		—
10. TOTAL INCOME IN ITEMS 1 TO 9		$ 66499 53
DEDUCTIONS		
11. Interest Paid	$ 29 85	
12. Taxes Paid. (Explain in Schedule F)	2165 28	
13. Losses by Fire, Storm, etc. (Explain in Table on page 3)		
14. Bad Debts. (Explain in Schedule F)		
15. Contributions. (Explain in Schedule F)	574 25	
16. Other Deductions Authorized by Law. (Explain in Schedule F)		
17. TOTAL DEDUCTIONS IN ITEMS 11 TO 16		$ 2769 38
18. NET INCOME (Item 10 minus Item 17)		$ 63730 15

COMPUTATION OF TAX (See Instruction 21)

19. Earned Net Income (not over $30,000)	$ 20 000	31. Net Income (Item 18 above)	$ 63730 15	42. Normal Tax (1½% of Item 35)	$ 60
20. Less Personal Exemption and Credit for Dependents (see Instruction 20)	3900	32. Less Dividends (Item 7 above)	$ 9005 04	43. Normal Tax (3% of Item 40)	120
21. Balance (Item 19 minus 20)	$ 16100	33. Interest on Liberty Bonds, etc. (Item 8)	—	44. Normal Tax (5% of Item 41)	2140 60
22. Amount taxable at 1½% (not over the first $4,000 of Item 21)	$ 4000	34. Personal Exemption	3500	45. Surtax on Item 18 (see Instruction 21)	4996 60
23. Amount taxable at 3% (not over the second $4,000 of Item 21)	4000	35. Credit for Dependents	400	46. Tax on Net Income (total of Items 42, 43, 44, and 45)	$ 7316 80
24. Amount taxable at 5% (balance over $8,000 of Item 21)	8100	36. Total of Items 32, 33, 34, and 35	13905 04	47. Less Credit of 25% of Tax on Earned Net Income (Item 30)	201 25
25. Normal Tax (1½% of Item 22)	$ 60	37. Balance (Item 31 minus 36)	$ 50825 11	48. Balance (Item 46 minus 47)	$ 7115 55
26. Normal Tax (3% of Item 23)	120	38. Amount taxable at 1½% (not over the first $4,000 of Item 37)	4000	49. Adjustment for Capital Gain or Loss (12½% of Column 9, Schedule D)	—
27. Normal Tax (5% of Item 24)	405	39. Balance (Item 37 minus 38)	$ 46825 11	50. Total Tax (total of or difference between Items 48 and 49)	$ 7115 55
28. Surtax on Item 19 (see Instruction 21)	330	40. Amount taxable at 3% (not over the second $4,000 of Item 37)	4000	51. Less Income Tax Paid at Source	—
29. Tax on Earned Net Income (total of Items 25, 26, 27, and 28)	$ 915	41. Amount taxable at 5% (balance over $8,000 of Item 37)	$ 42825 11	52. Income and Profits Taxes paid to a foreign country or U. S. possession	—
30. Credit of 25% of Item 29 (not over 25% of Items 39, 42, 43, and 44)	$ 201 25			53. Balance of Tax (Item 50 minus Items 51 and 52)	$ 7115 55

TAXPAYER'S RECORD OF PAYMENTS

Purchase	Amount	Date	Check or M. O. No	Bank or Office of Issue
First				
Second				
Third				

Nos. 6649 - 50 - 51
Schafer v. Helvering

SCHEDULE A—INCOME FROM BUSINESS OR PROFESSION (See Instruction 2)

1. Total receipts from business or profession (state kind of business) ..... $

Cost of Goods Sold

2. Labor	$	
3. Material and supplies		
4. Merchandise bought for sale		
5. Other costs (itemize below or on separate sheet)		
6. Plus inventory at beginning of year		
7. Total (Lines 2 to 6, inclusive)	$	
8. Less inventory at end of year		
9. Net Cost of Goods Sold (Line 7 minus Line 8)	$	

Note.—Do not deduct here or elsewhere compensation for your services.

Other Business Deductions

10. Salaries, exclusive of "Labor," reported on Line 2, and exclusive of compensation for your services	$	
11. Interest on business indebtedness to others		
12. Taxes on business and business property		
13. Losses by fire, storm, etc. (explain in table provided therefor at foot of page)		
14. Bad debts arising from sales or services		
15. Depreciation, obsolescence, and depletion (explain in table provided therefor at foot of page)		
16. Rent, repairs, and other expenses (itemized below or on separate sheet		
17. Total (Lines 10 to 16, inclusive)	$	
18. Total Deductions (Line 9 plus Line 17)		$
19. Net Profit (Line 1 minus Line 18) (Enter as Item 2)		$

Explanation of deductions claimed on Lines 5 and 16

SCHEDULE B—INCOME FROM RENTS AND ROYALTIES (See Instruction 5)

1. Kind of Property	2. Amount Received	3. Cost	4. Value as of March 1, 1913	5. Depreciation (Explain in table at foot of page)	6. Repairs	7. Other Expenses (Itemize below)	8. Net Profit (Enter as Item 4)
	$	$	$	$	$	$	$

Explanation of deductions claimed in Column 7

SCHEDULE C—PROFIT FROM SALE OF REAL ESTATE, STOCKS, BONDS, ETC. (See Instruction 6)

1. Kind of Property	2. Date Acquired	3. Amount Received	4. Depreciation Allowable since Acquisition	5. Cost	6. Value as of March 1, 1913	7. Subsequent Improvements	8. Net Profit (Enter as Item 6)
Securities	1926 & 1927	$ 202604 85	$	$ 196652 50	$	$ —	$ 6027 35

State how property was acquired

SCHEDULE D—CAPITAL NET GAIN OR LOSS FROM SALE OF ASSETS HELD MORE THAN TWO YEARS (See Instruction 6a)

1. Kind of Property	2. Date Acquired (Mo. Day Year)	3. Date Sold (Mo. Day Year)	4. Amount Realized	5. Depreciation Allowable since Acquisition	6. Cost	7. Value as of March 1, 1913	8. Subsequent Improvements and Capital Deductions	9. Net Gain or Loss (Enter 12½% of Item 9)
			$	$	$	$	$	$

State how property was acquired

SCHEDULE E—INTEREST ON LIBERTY BONDS AND OTHER OBLIGATIONS OR SECURITIES (See Instruction 8)

1. Obligations or Securities	2. Interest Received or Accrued	3. Amount Owned	4. Par Value Amount Exempt from Taxation	5. Amount Owned in Excess of Exemption	6. Interest on Amount in Excess of Exemption (Enter as Item 10)
(a) Obligations of a State, Territory, or political subdivision thereof, or the District of Columbia	$	$	All	XXXXXX	XXXXXX
(b) Securities issued under Federal Farm Loan Act, or under such Act as Amended			All	XXXXXX	XXXXXX
(c) Liberty 3½% Bonds and other obligations of United States issued on or before September 1, 1917, and obligations of possessions of the United States			All	XXXXXX	XXXXXX
(d) Liberty 4% and 4¼% Bonds, Treasury 3½%, 3¾%, 4%, and 4¼% Bonds, Treasury Certificates of Indebtedness, and Treasury (War) Savings Certificates			$5,000	$	$
(e) Treasury Notes			None		

SCHEDULE F—EXPLANATION OF DEDUCTIONS CLAIMED IN ITEMS 1, 12, 14, 15, AND 16

Taxes - Real Estate - $5826 Automobile 15.00 N.Y. State Income Tax 1093.42 Luxury 5.00 -

Contributions - Hebrew Orphan Asson 25 Foreign Relief Assn 5 Hebrew Orphan Asylum 100
Jewish Publication Society 5 Jewish Theological Seminary 10 Charity Organization 10
Chamber of Commerce 25.00 Jewish Federation 115.00 Cancer & York Co Assn 31.25 Big Brothers 5
SPCA NY 5.00 - YMCA Yonkers 6.00 Junior Society - Temple 5.00 SPCA Yonkers 10 -
National Security League 5 Stadium Concerts 25 Officers Assn 9 2nd Regiment 25 -
YMCA Marblehead 5 - Orange Home 10 - NY League - Hard of Hearing 15
Community Club - Jewish Fed Yonkers 100 - Am Red Star - 5 -

EXPLANATION OF DEDUCTION FOR DEPRECIATION CLAIMED IN SCHEDULES A AND B

1. Kind of Property (If buildings, state material of which constructed)	2. Date Acquired	3. Age When Acquired	4. Probable Life After Acquirement	5. Cost (Exclusive of Land)	6. Value as of March 1, 1913 (Exclusive of Land)	Amount of Depreciation Charged Off: 7. Previous years	8. This year
				$	$	$	$

EXPLANATION OF DEDUCTION FOR LOSSES BY FIRE, STORM, ETC., CLAIMED IN SCHEDULE A, AND IN ITEM 13

1. Kind of Property	2. Date Acquired	3. Cost	4. Value as of March 1, 1913	5. Subsequent Improvements	6. Depreciation Allowable since Acquisition	7. Insurance and Salvage Value	8. Net Taxable Loss
		$	$	$	$	$	$

Nos. 6649 - 50 - 51
Schafer v. Helvering

PETITIONER'S EXHIBIT #9 FOR IDENTIFICATION

A. S.—1927

Lines 18 and 31—Net Income reported			$63,730.15
Dif. stocks at cost—less			9,154.66
Lines 18 and 31, revised			54,575.49
Less exemption			12,905.04
Item 37			41,670.45
" 38			4,000.00
" 39			37,670.45
" 40			4,000.00
" 41			33,670.45

[fol. 79]

Item 42—1½%			$60.
" 43—3%			120.
" 44—5%			1,683.52
" 45—Surtax			3,600.57
" 46			$5,464.09
" 47—Less credit			201.25
" 48			5,262.84
" 49—Capital gain			0
" 53			5,262.84
Tax paid	$7,116.83	16% on $3,730.15	$596.82
Would have paid	5,262.84	15% on $4,000.	600
		14% on $1,424.61	199.44
Excess	1,853.99	5% on $9,154.66	457.73
			$1,853.99
$52,000, 13%			$3,240
2,575.49, 14%			360.57
			$3,600.57

A. S. paid normal tax 5%	$2,141.26	
Would have paid	1,683.52	
	457.74	457.74
Paid surtax	4,996.82	
Would have paid	3,600.57	
	1,396.25	1,396.25
		$1,853.99

[fol. 80] [File endorsement omitted]

IN COURT OF APPEALS OF THE DISTRICT OF COLUMBIA

Docket No-. 72370, 72373, 72374 (Consolidated Proceedings)

[Title omitted]

PRÆCIPE FOR RECORD—Filed August 6, 1935

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, and within the time allowed by law, transmit to the Clerk of the United States Court of Appeals of the District of Columbia, duly certified copies of the following documents and records in the above-entitled cause in connection with the petition for review by the said Court of Appeals for the District of Columbia, heretofore filed by the petitioners:

1. Docket entries of the proceedings before the Board.
2. Pleadings before the Board, as follows:
(a) The Petition (including notice of deficiency attached thereto) filed by each of said petitioners.
(b) Answer filed by respondent to each of said petitions.
3. Findings of fact, opinion, and decision of the Board.
4. Statement of evidence, together with proof of service of copy of same upon respondent.
5. The several exhibits made a part of said statement of evidence by reference, including: Respondent's Exhibit "A"; Petitioners' Exhibit 1, and Petitioners' Exhibits for Identification 2, 3, 4, 5, 6, 7, 8 and 9.

6. The petition for review filed by petitioners, together with proof of service of notice of filing of petition for review and of service of copy of petition for review.

[fol. 81] 7. Stipulation of venue.

8. This præcipe.

Eugene Untermyer, Attorney for Petitioners, 30 Pine Street, New York, N. Y. 716 Investment Building, Washington, D. C.

Agreed to. Robert H. Jackson, Counsel for Respondent.

Clerk's certificate to foregoing transcript omitted in printing.

[fol. 82] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 72370, 72373 and 72374

[Title omitted]

ORDER ENLARGING TIME

For cause appearing of record, it is

Ordered: That the time for transmission and delivery of the record sur petition for review of the above entitled proceeding in the United States Court of Appeals for the District of Columbia, be and it is hereby extended to September 23, 1935.

(Signed) C. Rogers Arundell, Member.

Dated, Washington, D. C., Aug. 20, 1935
jd.

Now, Aug. 30, 1935, the foregoing is certified from the record as a true copy.

B. D. Gamble, Clerk, U. S. Board of Tax Appeals.
(Seal U. S. Board of Tax Appeals.)

[File endorsement omitted.]

[fol. 83] Thursday, February 6th, A. D. 1936.

No. 6549

ALGERNON S. SCHAFER, Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue

No. 6550

EDWARD SCHAFER, Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue

and

No. 6551

LEONARD SCHAFER, Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue

The argument in the above entitled causes was commenced by Mr. Edgar J. Goodrich, attorney for petitioners, and was continued by Mr. Carlton Fox, attorney for respondent, and was concluded by Mr. Edgar J. Goodrich, attorney for petitioners. Petitioners allowed to file supplemental memorandum. (Mr. Justice Van Orsdel not sitting.)

[fol. 84] UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

Nos. 6549, 6550, 6551

ALGERNON S. SCHAFER, Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue, Respondent

EDWARD SCHAFER, Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue, Respondent

LEONARD SCHAFER, Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue, Respondent

On Petition for Review of Decisions of the United States Board of Tax Appeals

Argued February 6, 1936. Decided March 2, 1936

Edgar J. Goodrich, of Washington, D. C., for petitioners.
Frank J. Wideman, Assistant Attorney General, Sewall Key, Carlton Fox, Robert H. Jackson, and Hugh Brewster, all of Washington, D. C., for respondent.

Before Martin, C. J., and Robb, Groner, and Stephens, JJ.

GRONER, J.:

This is a petition to review an order of the Board of Tax Appeals finding deficiencies for the calendar year 1929. The question is whether petitioners are entitled to have their income for the taxable year computed by reference to inventories of securities taken at market value at the beginning and end of the year.

Petitioners were general partners in the partnership of Schafer Bros., New York City. The partnership was engaged in the general stock brokerage business. One of the

partners owned a Stock Exchange seat and was the floor member. The other two were the office members. All three were actively engaged in the business. "The partnership was a dealer and merchant in securities on commission and on margin. Such business activity comprised the execution of orders for purchase or sale of securities by its customers either on the Exchange, the Curb, or wherever the particu-[fol. 85] lar securities were listed." It participated in syndicate and underwriting operations. "Also, as a part of its business activities, but with no relation to its customers' accounts nor to the execution of orders for its customers, the partnership has always to some extent, bought and sold securities for its own account. * * * Such trading was conducted through orders executed by Leonard Schafer [the floor member] or other brokers and had no relation to or connection with the accounts of the partnership's customers, but were purchased in expectation of a rise in the market price and for the purpose of resale, to any buyer, at a profit for the partnership's own account. Such securities were not purchased for investment." Sales of the securities purchased were made through orders given Leonard Schafer or other brokers and the identity of the buyer was not known. The record of purchases and sales was kept in a separate account book. Prior to 1925 the partnership carried its own securities at cost, but beginning with that year and including 1929 it inventoried, at fair market value, such securities at the beginning and end of the year. "The change was made as a matter of business policy, but with knowledge of the effect of the taxing statutes. The New York Stock Exchange, since about 1923, has required its members to inventory securities for the purpose of certain Exchange questionnaires."

The Commissioner determined that the partnership was not a dealer with respect to such securities and disallowed the use of inventories, and increased the partnership income by the amount of $511,667.00. The Board sustained the Commissioner, on the ground that in the purchase and sale of stocks for its own account the firm was a speculator and not a dealer within the provisions of the statute and regulations.

Petitioners rely upon Commissioner v. Stevens (Second Circuit), 78 F. (2d) 713, and Commissioner v. Charavay

(Third Circuit), 79 F. (2d) 406, and insist that the facts in those cases and in this are indistinguishable; and in our opinion this is correct. If we follow them, we should be content to accept their conclusions as our own; but after careful thought, and with great deference, we are constrained to adopt a different view.

The applicable statute is Section 22 of the Revenue Act of 1928. Subsection (c) provides:

"Whenever in the opinion of the Commissioner the use of inventories is necessary in order to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income".

The Section is general and casts upon the Commissioner the duty of adapting it to the conditions it was intended to cover, and gives to his regulation the force of law. The decision, therefore, necessarily turns upon the interpretation of the Commissioner's regulation. It is as follows:

"Art. 105. Inventories by dealers in securities.—A dealer in securities, who in his books of account regularly inventories unsold securities on hand either—

(a) At cost;

(b) At cost or market, whichever is lower; or

(c) At market value,

[fol. 86] may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the Commissioner. For the purpose of this rule a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not

for investment. Taxpayers who buy and sell or hold securities for investment or speculation and not in the course of an established business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule."

Slightly paraphrased, the regulation is that a dealer in securities, with an established place of business, regularly engaged as a merchant in the purchase of securities, not for investment, but for resale to customers with a view to gain and profit, is entitled to have his income computed on inventories.

It should, however, be borne in mind in considering the regulation that Section 22 (c) is not applicable alone to dealers in stocks and bonds. It covers all classes of business. In the case of the ordinary storekeeper the regulation would necessarily differ somewhat from that in the case of a dealer in securities, but only in details. As promulgated by the Commissioner, the underlying principle in each is the same. There has to be a license or right to conduct the business, a holding out to the public, an offering of wares or securities for sale, and customers to sell to. In the case we are considering petitioners' firm was licensed to do a stock brokerage business, which we assume would include buying and selling on commission and dealing generally in what are popularly known as marketable securities. Petitioners have an established place of business and held themselves out to their customers as authorized and qualified to buy or sell for them, as broker, shares of stocks and bonds; but there is not a word of evidence that they likewise hold themselves out as having on hand securities for sale on their own account, or that they personally or through salesmen carry on the business of selling their own securities to their own customers. There is no evidence that they offer for sale to the public securities in the sense that a merchant offers for sale his stock in trade, and the fair conclusion from their own evidence is that they never thought of themselves as merchants or as engaged in merchandising as that term is commonly understood.

What they did was to use their funds and their expert knowledge of market conditions in the purchase on the exchanges of stocks and bonds from brokers, in anticipation of a rise in price, and the subsequent sale of the same stocks

and bonds, under the same conditions, through the same or other brokers. The motive was neither more nor less than that which induces every such transaction by the public generally—transactions which occur daily on the exchanges and which are universally known and designated as speculations.—There is a distinction between this plan and the plan more or less common a few years ago with certain [fol. 87] large banking institutions and their subsidiaries of setting up so-called investment departments to underwrite and purchase bonds and stocks, and to peddle them out to customers through solicitation or contacts. In such cases the analogy to ordinary merchandising is nearly or quite complete. The element of resale to customers—i. e., people who regularly or repeatedly deal with them—necessitates both possession of the thing to be sold and customers to sell it to. In the present case the last element is wholly lacking. Petitioners never had in mind disposing of their securities to their partnership's customers. If, for instance, one of the latter had ordered the purchase for his account of 1,000 shares of Steel stock, it is unthinkable that petitioners would in such case have made delivery to him of 1,000 shares of that stock belonging to themselves. And this is obvious, because that was not their manner of doing business. The fair inference from their testimony is that their transactions in the stocks and bonds in question, both as to purchase and sale, were and were intended to be consummated only through the instrumentality of brokers on some of the exchanges. In this, they neither had a customer nor knew one, and hence were not—"*one who as a merchant buys securities and sells them to customers*". Their stock brokerage business was their profession. The buying and selling for their own account was a side line which is none the less speculation because done by one engaged in the security business. In this view we cannot follow the conclusion reached in the Stevens case nor concede, as is stated there, that when petitioners' firm purchased shares of stock, these were "its wares" or stock in trade, nor when it sold them through its own broker to another broker, the latter broker was the sort of customer contemplated by the regulation.

No more can we accept the statement in the Charavay case that the controlling factor "is not the method by which the partnership obtained customers or made sales," but "it

is the fact that the partnership purchased securities and held them, not for investment or speculation, but for resale at a profit to any one who desired to buy." We think, on the contrary, that the element of speculation alone inheres in a transaction of the nature we are concerned with, and that it is inaccurate to call it anything else.

But counsel for petitioners point to the language of the concluding paragraph of the regulation as sustaining their view. It reads: "Taxpayers who buy and sell or hold securities for investment or speculation *and* not in the course of an established business, * * * are not dealers in securities within the meaning of this rule." The use of the word "and" which we have italicized is unfortunate and gives ground to argue that neither investors nor speculators are forbidden the use of inventories if the transactions are made in the course of an established business. But as to this we agree with the view expressed by Judge Learned Hand in Seeley v. Commissioner, 77 F. (2d) 323, in reply to the same argument—that though the use of the word "and" rather than "or" may throw a faint shadow across the earlier words, it cannot obscure them.

Counsel also tell us that petitioners are entitled to inventory their securities for the year in question in reliance upon the practice of the Bureau of Internal Revenue in prior years and the expressed views of the Bureau on the subject. It is said that regularly for four years preceding [fol. 88] 1929 the partnership inventoried its securities with the knowledge and approval of the Bureau. It is also said, and doubtless is true, that during some of those years—perhaps all of them—the method of computing income now insisted on by the Commissioner, if then applied, would have resulted in a smaller tax; but granting this, and granting also that the Bureau's willingness to leave undisturbed the practice until 1929 was induced by the larger tax accruing to the government, such action or lack of action cannot estop the government now from insisting upon compliance with its laws. Wrongs between man and man, which shock the conscience and justify the intervention of a court of equity, cannot affect or prejudice the sovereign in the right to demand the full measure of the statute. Whoever deals with the government does so with notice that no agent can, by neglect or acquiescence, commit it to an erroneous interpretation of the law. Helvering v. Trust Co., 292 U. S. 455-466; Seeley v. Commissioner, 77 F. (2d) 323.

True enough, petitioners might have altogether avoided the tax now assessed by selling their stocks and immediately rebuying them, and it is likely they would have done so but for their reliance upon the repeated approval of the other method by the Bureau; but even that cannot help them if the old interpretation of the regulation by the Bureau was wrong—and it is convincingly clear to us it was.

Order affirmed.

A true copy. Test.

—— ——, Clerk of the United States Court of Appeals, for the District of Columbia.

[fol. 89] Monday, March 2nd, A. D. 1936.

January Term, 1936

No. 6549

ALGERNON S. SCHAFER, Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue

Petition for Review from the Board of Tax Appeals

This cause came on to be heard on the transcript of the record from the Board of Tax Appeals and was argued by counsel.

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the decision of the said Board of Tax Appeals in this cause be, and the same is hereby, affirmed.

Per Mr. Justice Groner.

March 2, 1936.

Mr. Justice Van Orsdel took no part in the consideration or decision of this case.

[fol. 90] Monday, March 2nd, A. D. 1936.

January Term, 1936

No. 6550

EDWARD SCHAFER, Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue

Petition for Review from the Board of Tax Appeals

This cause came on to be heard on the transcript of the record from the Board of Tax Appeals and was argued by counsel.

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the decision of the said Board of Tax Appeals in this cause be, and the same is hereby, affirmed.

Per Mr. Justice Groner.

March 2, 1936.

Mr. Justice Van Orsdel took no part in the consideration or decision of this case.

[fol. 91] Monday, March 2nd, A. D. 1936.

January Term, 1936

No. 6551

LEONARD SCHAFER, Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue

Petition for Review from the Board of Tax Appeals

This cause came on to be heard on the transcript of the record from the Board of Tax Appeals and was argued by counsel.

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the decision of the

True enough, petitioners might have altogether avoided the tax now assessed by selling their stocks and immediately rebuying them, and it is likely they would have done so but for their reliance upon the repeated approval of the other method by the Bureau; but even that cannot help them if the old interpretation of the regulation by the Bureau was wrong—and it is convincingly clear to us it was.

Order affirmed.

A true copy. Test.

—— ——, Clerk of the United States Court of Appeals, for the District of Columbia.

[fol. 89] Monday, March 2nd, A. D. 1936.

January Term, 1936

No. 6549

ALGERNON S. SCHAFER, Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue

Petition for Review from the Board of Tax Appeals

This cause came on to be heard on the transcript of the record from the Board of Tax Appeals and was argued by counsel.

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the decision of the said Board of Tax Appeals in this cause be, and the same is hereby, affirmed.

Per Mr. Justice Groner.

March 2, 1936.

Mr. Justice Van Orsdel took no part in the consideration or decision of this case.

[fol. 90] Monday, March 2nd, A. D. 1936.

January Term, 1936

No. 6550

EDWARD SCHAFER, Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue

Petition for Review from the Board of Tax Appeals

This cause came on to be heard on the transcript of the record from the Board of Tax Appeals and was argued by counsel.

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the decision of the said Board of Tax Appeals in this cause be, and the same is hereby, affirmed.

Per Mr. Justice Groner.

March 2, 1936.

Mr. Justice Van Orsdel took no part in the consideration or decision of this case.

[fol. 91] Monday, March 2nd, A. D. 1936.

January Term, 1936

No. 6551

LEONARD SCHAFER, Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue

Petition for Review from the Board of Tax Appeals

This cause came on to be heard on the transcript of the record from the Board of Tax Appeals and was argued by counsel.

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the decision of the

said Board of Tax Appeals in this cause be, and the same is hereby, affirmed.

Per Mr. Justice Groner.

March 2, 1936.

Mr. Justice Van Orsdel took no part in the consideration or decision of this case.

[fol. 92] UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

No. 6549

ALGERNON S. SCHAFER, Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue, Respondent

No. 6550

EDWARD SCHAFER, Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue, Respondent

No. 6551

LEONARD SCHAFER, Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue, Respondent

DESIGNATION OF RECORD

Come now petitioners herein by their counsel and request the Clerk of this honorable Court to prepare a transcript of record on application for a Writ of Certiorari to the Supreme Court of the United States in the above entitled cases, and including the following;

(1) Transcript of record.
(2) Minute entry of argument.
(3) Opinion.

[fol. 93] (4) Decree.
(5) This designation of record.
(6) Certificate of Clerk.

Algernon Schafer, Edward Schafer, Leonard Schafer, by Edgar J. Goodrich, Counsel for Petitioners, 716 Investment Building, Washington, D. C.

Service accepted this 9th day of March, 1936.
Robert H. Jackson, Attorney for Respondent.

[fol. 94] [Endorsed:] United States Court of Appeals for the District of Columbia. No. 6549. Algernon S. Schafer, Petitioner, v. Guy T. Helvering, Commissioner of Internal Revenue, Respondent. No. 6550. Edward Shafer, Petitioner, v. Guy T. Helvering, Commissioner of Internal Revenue, Respondent. No. 6551. Leonard Schafer, Petitioner, v. Guy T. Helvering, Commissioner of Internal Revenue, Respondent. Designation of Record. United States Court of Appeals for the District of Columbia. Filed Mar. 9, 1936. Henry W. Hodges, Clerk. Edgar J. Goodrich, Attorney at Law, Investment Building, Washington, D. C.

[fol. 95] UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

I, Henry W. Hodges, Clerk of the United States Court of Appeals for the District of Columbia, do hereby certify that the foregoing printed and typewritten pages numbered from 1 to 94, inclusive, constitute a true copy of the transcript of record and proceedings of the said Court of Appeals as designated by counsel in the cases of Algernon S. Schafer, Petitioner, vs. Guy T. Helvering, Commissioner of Internal Revenue; Edward Schafer, Petitioner, vs. Guy T. Helvering, Commissioner of Internal Revenue; Leonard Schafer, Petitioner, vs. Guy T. Hervering, Commissioner of Internal Revenue, Nos. 6549, 6550, 6551, January Term, 1936, as the same remain upon the files and records of said Court of Appeals.

In testimony whereof, I hereunto subscribe my name and affix the seal of said Court of Appeals, at the City of Washington, this 10th day of March, A. D. 1936.

Henry W. Hodges, Clerk of the United States Court of Appeals for the District of Columbia, by Moncure Burke, Deputy Clerk. (Seal United States Court of Appeals for the District of Columbia.)

[fol. 96] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1936

No. 24

ORDER ALLOWING CERTIORARI—Filed May 18, 1936

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 97] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1936

No. 25

ORDER ALLOWING CERTIORARI—Filed May 18, 1936

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 98] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1936

No. 26

ORDER ALLOWING CERTIORARI—Filed May 18, 1936

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File Nos. 40,449, 40,450, 40,451. District of Columbia, U. S. Court of Appeals. Term No. 24. Algernon S. Schafer, petitioner, vs. Guy T. Helvering, Commissioner of Internal Revenue. Term No. 25. Edward Schafer, petitioner, vs. Guy T. Helvering, Commissioner of Internal Revenue. Term No. 26. Leonard Schafer, petitioner, vs. Guy T. Helvering, Commissioner of Internal Revenue. Petition for writs of certiorari and exhibit thereto. Filed April 6, 1936. Term Nos. 24, O. T., 1936; 25, O. T., 1936; 26, O. T., 1936.

(7886-C)

FILED
APR 6

IN THE

Supreme Court of the United States

October
APRIL TERM, 1936 (1935)

24

ALGERNON S. SCHAFER, *Petitioner*,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

25

EDWARD SCHAFER, *Petitioner*,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

26

LEONARD SCHAFER, *Petitioner*,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA AND BRIEF IN SUPPORT THEREOF

EUGENE UNTERMYER,
30 Pine Street,
New York, N. Y.,

EDGAR J. GOODRICH,
Investment Building,
Washington, D. C.,

Counsel for Petitioners.

The Hecla Press, 225 Varick Street, N. Y. C. Tel. WAlker 5-1454.

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IN THE

Supreme Court of the United States

October
~~APRIL~~ TERM, ~~1936~~ 1935

ALGERNON S. SCHAFER, Petitioner, v. GUY T. HELVERING, Commissioner of Internal Revenue, Respondent.	No.....
EDWARD SCHAFER, Petitioner, v. GUY T. HELVERING, Commissioner of Internal Revenue, Respondent.	No.....
LEONARD SCHAFER, Petitioner, v. GUY T. HELVERING, Commissioner of Internal Revenue, Respondent.	No.....

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA, AND BRIEF IN SUPPORT THEREOF.

The petitioners, Algernon S. Schafer, Edward Schafer and Leonard Schafer, by their attorneys, Eugene Untermyer and

Edgar J. Goodrich, pray that Writs of Certiorari issue to review the decisions of the United States Court of Appeals for the District of Columbia, rendered in the above-entitled cases on March 2, 1936, affirming the Orders of the United States Board of Tax Appeals entered March 30, 1935 (32 B. T. A. 289) (R. 33-42), approving the determinations of the Commissioner of Internal Revenue finding deficiencies in income tax for the calendar year 1929 as to each petitioner.

Question Presented.

Was the partnership of which these petitioners were members a "dealer in securities" as to securities bought and sold for its own account, and as such entitled to inventory such securities at cost or market, whichever was lower, in computing its income for 1929?

The same question is involved in each of these cases since the income of each petitioner for 1929 includes his distributable share of the income of the partnership for that year. Determination of the amount thus to be included in the income of each petitioner depends upon the basis upon which the partnership income is computed.

This identical issue, which involves the liabilities of many taxpayers, has been decided by the Courts of Appeal for the Second and Third Circuits in cases indistinguishable upon their facts from the instant proceedings, in direct contradiction to the decision herein of the Court of Appeals of the District of Columbia.

Statutes and Regulations Involved.

Revenue Act of 1928 (U. S. C. A., Title 26, Chap. 1, p. 51):

> "SECTION 22(c): *Inventories:* Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such tax-

payer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income."

Regulations 74:

"ARTICLE 106. *Inventories by Dealers in Securities.* A dealer in securities, who in his books of account regularly inventories unsold securities on hand either—

(a) At cost;
(b) At cost or market, whichever is lower; or
(c) At market value,

may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the Commissioner. For the purpose of this rule a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merc' buys securities and sells them to customers wit a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment or speculation and not in the course of an established business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule."

Statement.

These cases were consolidated for trial below. At all times here material the petitioners were general partners, each having a one-third interest, in the firm of Schafer Brothers,

which was an established firm, engaged for upwards of fifty years as members of the New York Stock Exchange in the business of a broker and dealer in securities. Its activities included (1) the execution of orders for purchase or sale upon the various Exchanges of securities for its customers, (2) the participation in syndicate and underwriting operations, and (3) the purchase and sale of securities for profit on its own account, which was an essential part of the firm's business and had been so for many years.

From 1925 to 1929, inclusive, in accordance with a ruling published by the Treasury Department in 1922 that stood unquestioned for some nine years, and as it was required by the rules of the New York Stock Exchange, the firm inventoried the securities purchased and held by it for resale at a profit, at market values at the beginning and end of the year, and determined its income from this source upon the inventory basis.

This method of computing the firm's income was accepted by the Commissioner for all years up to 1929. For that year, in auditing the firm's returns in 1931, he denied the partnership the right to use the inventory basis in computing its income on the ground that the firm was not a "dealer in securities" with respect to the securities which it purchased and sold for its own account that had remained unsold at the beginning and end of the taxable year.

This action resulted in increasing the firm's income for 1929 (in prior years such action would have decreased the firm's income) and consequently increased substantially the taxable income of each of the partners. Based on such increases to the firm's and to the individual's incomes, the Commissioner determined tax deficiencies for 1929 against these petitioners in the respective amounts of $33,329.20, $33,423.09 and $32,687.97.

Against these determinations of the Commissioner, petitioners appealed to the Board of Tax Appeals, which affirmed. From the decisions of the Board of Tax Appeals, petitioners appealed to the Court of Appeals of the District of Columbia. That Court affirmed the Board's order, ex-

pressly refusing to follow prior decisions of identical issues by the Courts of Appeal for the Second and Third Circuits in cases indistinguishable upon their facts from the instant proceedings.

The issuance of mandates has been stayed pending action upon application in this Court for Writs of Certiorari.

Specification of Errors to Be Urged.

The Court of Appeals of the District of Columbia erred:

1. In failing to hold that the firm of Schafer Brothers was a dealer in securities in 1929 as to those securities which it bought and sold for profit on its own account, and as such entitled to determine its income for 1929 upon the inventory basis.

2. In failing to hold that the use of inventories in 1929 by the firm of Schafer Brothers with respect to the securities it bought and sold for profit on its own account was essential in order clearly to determine the income of the firm, and consequently the income of each of these petitioners, in accordance with the best accounting practice, with the requirements of the Bureau of Internal Revenue and with the rules of the Stock Exchange.

3. In holding, directly in contradiction to decisions by the Courts of Appeal for the Second and Third Circuits upon issues identical with those here involved arising under factual situations indistinguishable from those obtaining in these proceedings, that the firm of Schafer Brothers was not a dealer in securities in 1929 as to the securities in which it traded for profit on its own account, and as such entitled to the use of inventories respecting such securities in determining its income and the respective distributable shares thereof of each of these petitioners.

Reasons for Granting the Writs.

1. The decision of the Court of Appeals of the District of Columbia is in irreconcilable conflict on a matter of statutory interpretation with the decision of the Court of Appeals for the Second Circuit in *Commissioner* v. *Stevens*, 78 Fed. (2d) 713, and with the decision of the Court of Appeals for the Third Circuit in *Commissioner* v. *Chararay*, 79 Fed. (2d) 406.

2. The precise question of statutory construction here presented is one of general public importance which has never been settled, and should be determined by this Court because of the number of pending cases involving the question, as well as the frequent occasions that the question is bound to arise in the future.

WHEREFORE, it is respectfully submitted that this petition should be granted.

Dated April 6, 1936.

ALGERNON S. SCHAFER,
EDWARD SCHAFER,
LEONARD SCHAFER,
Petitioners,

By EUGENE UNTERMYER,
30 Pine Street,
New York, N. Y.,

EDGAR J. GOODRICH,
Investment Building,
Washington, D. C.,

Counsel for Petitioners.

IN THE

Supreme Court of the United States

October
~~APRIL~~ TERM, ~~1936~~. 1935

ALGERNON S. SCHAFER, Petitioner, v. GUY T. HELVERING, Commissioner of Internal Revenue, Respondent.	No.....
EDWARD SCHAFER, Petitioner, v. GUY T. HELVERING, Commissioner of Internal Revenue, Respondent.	No.....
LEONARD SCHAFER, Petitioner, v. GUY T. HELVERING, Commissioner of Internal Revenue, Respondent.	No.....

BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI.

Statement.

The facts, the question presented, the opinions below, the statute and regulations involved, and the specification of errors are all set out in the Petition.

The *jurisdiction of this Court* is invoked under Section 240(a) of the Judicial Code, as amended by Act of February 13, 1925 (c-229, #1, 43 Stat. 938).

This brief is directed, not to the merits of the decisions below imposing upon petitioners the tax liabilities complained of, but solely to the reasons impelling review of these cases and decisions of the issues involved by this Court.

Argument.

(1) The decision of the Court of Appeals of the District of Columbia is in irreconcilable conflict on a matter of statutory interpretation with the decision of the Circuit Court of Appeals for the Second Circuit in *Commissioner* v. *Stevens*, 78 Fed. (2d) 713, and with the decision of the Circuit Court of Appeals for the Third Circuit in *Commissioner* v. *Charavay*, 79 Fed. (2d) 406.

The Court of Appeals of the District of Columbia by its express disagreement with the opinions of the Courts of Appeals for the Second and Third Circuits has created a direct conflict respecting the judicial definition and construction of the term "dealer in securities."

That this disagreement is a true conflict involving judicial interpretation of a statutory term and is not merely the result of distinguishing factual situations is expressly stated in the opinion of the Court of Appeals as follows:

> "Petitioners rely upon *Commissioner* v. *Stevens* (Second Circuit), 78 Fed. (2d) 713, and *Commissioner* v. *Charavay* (Third Circuit), 79 Fed. (2d) 406, and insist that the facts in those cases and in this are indistinguishable; and in our opinion this is correct. If we follow them, we should be content to accept their conclusions as our own; but after careful thought, and with great deference, we are constrained to adopt a different view."

A clear and undisputed construction and understanding of the term "dealer in securities" is essential to the proper application of the statutory provisions respecting the use of inventories by all persons engaged in the securities business in determining their annual income subject to tax.

If a taxpayer is a "dealer in securities," he is permitted to inventory at the beginning and end of each year the securities on hand which he has purchased for resale at a profit. If a taxpayer is not a "dealer in securities," his income derived from purchase and resale of securities is to be determined, not upon the inventory basis, but upon the basis of actual sales. Unless one method or the other is consistently followed there may be a substantial difference in any one year in computation of income from that source.

That result is demonstrated in the cases at bar. Here, Schafer Brothers for a number of years had computed its income from purchase and sales of securities for its own account on the inventory basis. The sudden rejection of that basis in 1931 by the Commissioner for the taxable year 1929 and the use by him of the actual sales basis in computing the firm's income for that year resulted in an increase on paper in the firm's income of $511,667 over the amount disclosed by its tax return. That change of course was reflected in increased computations of the incomes of the partners, these petitioners, resulting in the tax deficiencies here involved.

As the matter now stands, under the construction and interpretation of the term "dealer in securities" by the Courts of the Second and Third Circuits, the firm of Schafer Brothers was such a dealer, entitled to inventory its securities on hand and compute its income on the inventory basis.

We urge that the firm is in all respects a dealer in securities within the language of the Regulation (p. 3 of the Petition, *supra*) with respect to its purchases and sales of securities for its own account.

It had consistently inventoried its securities by the same method and adhered thereto in subsequent years.

The firm had an established place of business, regularly engaged in the purchase of securities and their resale to customers (the word customers includes "other brokers" as was determined in *Commissioner* v. *Stevens, supra,* p. 714) with a view to the gains and profits to be derived therefrom.

Such securities were all held for purpose of resale and not for investment, as was stipulated and found by the Board.

The transactions in question were in the course of an established business and not in the individual capacities of any of the partners.

The conclusion that Schafer Brothers was a "dealer" is inescapable, for by their decisions in the *Stevens* and *Chararay* cases (*supra*) those Courts held the firm of Stevens and Legg, engaged in a business precisely the same as that of Schafer Brothers, buying and selling securities for profit on its own account exactly as did Schafer Brothers, to be a "dealer in securities" with respect to such securities, and entitled to compute its income from that source on the inventory basis.

Under the construction of the term "dealer in securities" given by the Courts of the Second and Third Circuits, it follows that Schafer Brothers was such a dealer, and its tax return for 1929 correctly disclosed its income from purchase and sale of securities; so also did the individual tax returns of these petitioners, and they are not chargeable with the deficiencies asserted.

But under the construction and interpretation of that term by the Court of Appeals of the District of Columbia, its decision holds that the firm of Schafer Brothers was not a "dealer in securities," its income from purchase and resale of securities should be determined upon the actual sales basis and consequently its income as disclosed by its return was understated, as were also the incomes of these petitioners.

Consequently, the refusal of the Court of Appeals of the District of Columbia to accept and follow the prior decisions of the Court of the Second and Third Circuits, despite its admission that the factual situations in all three cases are

indistinguishable, evidences a fundamental conflict in construction and interpretation of a statutory term essential to a proper application of the statutory provisions. Because of this conflict opposite and irreconcilable results obtain in the different Circuits in cases arising upon the same set of facts.

Such a conflict, we submit, clearly indicates the necessity for examination and decision of these cases by this Court under Rule 38(5)(b), and we respectfully urge the writs be granted.

(2) The precise question of statutory construction here presented is one of general public importance which has never been settled, and should be determined by this Court because of the number of pending cases involving the question, as well as the frequent occasions on which the question is bound to arise in the future.

The necessity for decision of the issues here involved and the judicial construction of the essential term "dealer in securities" by this Court of highest authority is not confined to the demands of justice in the instant proceedings.

Upon the correct construction and interpretation of the statutory terms involved depends the proper determination of the tax liabilities of the substantial number of established business concerns engaged in the purchase and resale of securities. The proper status of the firm, whether as "dealers" or otherwise, the proper method upon which its accounts shall be kept and its income computed, and the resulting liabilities of the partners under the revenue laws all depend upon final and authoritative judicial determination of the issues involved in the cases now at bar.

Upon information, unofficial and unpublished, but which we believe to be dependable, we state that there are a very substantial number of cases involving these issues now pending in the Bureau of Internal Revenue.

There are also numerous cases which would be controlled by decision of this Court in the instant proceedings pending before the Board of Tax Appeals and the federal District

Courts, and upon appeal from those tribunals before the several Circuit Courts of Appeal. Because of the fundamental conflict now existing between the Courts of the Second and Third Circuits on the one hand and the Court of Appeals of the District of Columbia on the other clearly a definitive determination of these pending cases is impossible.

The sudden reversal of opinion by the Commissioner, in diametrical opposition to his practice of over nine years, was not impelled by any change in the Statutes or Regulations, since the above-quoted provision of the Revenue Act of 1928 and the appurtenant Regulation have stood substantially unchanged since the enactment of the Revenue Act of 1918.

The proper construction of the Statute and Regulation by the numerous class of concerns engaged in the same class of business has been rendered uncertain and impossible of determination because of the direct conflict of authority above referred to.

The issues here involved are therefore of widespread, practical and public importance, both to a large class of taxpayers and to the Treasury. For this reason we respectfully urge this Court to grant the writs now prayed for and undertake review of the instant proceedings.

CONCLUSION.

Wherefore, it is respectfully submitted that this petition for writs of certiorari to review the judgments of the Court of Appeals of the District of Columbia in these consolidated cases should be granted.

EUGENE UNTERMYER,
30 Pine Street,
New York, N. Y.,

EDGAR J. GOODRICH,
Investment Building,
Washington, D. C.,

Counsel for the Petitioners

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CHARLES ELMORE

Supreme Court of the United States

October Term, 1936.

ALGERNON S. SCHAFER, Petitioner, vs. GUY T. HELVERING, Commissioner of Internal Revenue, Respondent.	No. 24.
EDWARD SCHAFER, Petitioner, vs. GUY T. HELVERING, Commissioner of Internal Revenue, Respondent.	No. 25.
LEONARD SCHAFER, Petitioner, vs. GUY T. HELVERING, Commissioner of Internal Revenue, Respondent.	No. 26.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA.

BRIEF FOR PETITIONERS.

EUGENE UNTERMYER,
EDGAR J. GOODRICH,
Counsel for Petitioners.

The Hecla Press, 225 Varick Street, N. Y. C. Tel. WAlker 5-1490.

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Supreme Court of the United States

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ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA.

BRIEF FOR PETITIONERS.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (C. 229, No. 1, 43 Stat. 938), and Section 1003 of the Revenue Act of 1926.

This Court granted writs of certiorari on May 18, 1936, pursuant to petitions filed April 6, 1936 (R. 93).

Proceedings Below.

The writs are directed to the United States Court of Appeals for the District of Columbia which, by its opinion (R. 81-88) reported at 83 Fed. (2d) 317, affirmed a decision of the United States Board of Tax Appeals (R. 39-40) pursuant to its opinion (R. 31-39) reported at 32 B. T. A. 289, which in turn sustained deficiencies found by respondent against the three petitioners in respect of income derived from Schafer Brothers, a partnership, for the calendar year 1929.

The three cases were consolidated for trial by order of the Board (R. 40) and come before this Court on the same record of findings, testimony and exhibits.

Synopsis of the Questions Involved.

This appeal arises under the Revenue Act of 1928 and brings up the right of Schafer Brothers, a partnership holding membership on the New York Stock Exchange and composed of the three petitioners, as general partners, to inventory securities owned by said firm at the beginning and end of the tax year 1929 in arriving at the firm's income subject to income tax, and the consequent liability of petitioners as partners.

The considerations applicable are generally as follows:

(1) The right and obligation of the firm to inventory its securities in accordance with the best accounting practice in the trade or business and as most clearly reflecting the income, in order clearly to determine the income of the petitioners, as required by the Revenue Act of 1928, Section 22(c);

(2) The right of the partnership to be classified as a "dealer" in securities, under Article 105, Treasury Regulations 74, promulgated by respondent pursuant to said Act; and

(3) The effect of respondent's prior diametrically opposite rulings and interpretation of his regulations (which were not changed until over a year *after* income tax returns for 1929 were filed) upon the precise point.

Identical questions are involved in each case, since the justice of respondent's claim for a deficiency against each of the petitioners is dependent upon the amount of firm income for the year 1929.

Statutes and Regulations Involved.

Revenue Act of 1928 (U. S. C. A., Title 26, Chap. 1, p. 51), under the caption "Gross Income," provides by Section 22(c):

> "INVENTORIES.—Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income."

Treasury Regulations 74, promulgated under the Revenue Act of 1928, provides by Article 105:

> "INVENTORIES BY DEALERS IN SECURITIES.—A dealer in securities, who in his books of account regularly inventories unsold securities on hand either—
>
> (a) At cost;
> (b) At cost or market, whichever is lower; or
> (c) At market value,
>
> may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the Commissioner. For the purpose of

> this rule a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation and not in the course of an established business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule."

The above provisions of the Law and of the Regulations have persevered substantially unchanged since the enactment of the Revenue Act of 1918 in all the Acts including that of 1928.

Statement of Facts.

The findings of the Board (R. 32-34) and other undisputed facts of record are summarized as follows:

From 1918 to February, 1932, petitioners were general partners, each having a one-third interest in the New York Stock Exchange firm of Schafer Brothers, with an office and established place of business at No. 120 Broadway, New York City. The original firm of Schafer Brothers was established by petitioners' father and has been a member of the New York Stock Exchange since about 1865. Leonard Schafer had owned a "seat" since 1899 and was the "floor member," whereas the two remaining petitioners were the "office members" of the partnership. All three petitioners were actively engaged in the business of the firm (R. 32). Leonard Schafer was a "specialist" in a number of stocks traded on the Exchange.

Since its inception the present partnership was a dealer and merchant in securities on commission and on margin

(R. 33). Its principal activities included (1) the execution of orders for purchase or sale of securities upon the various Exchanges for its customers on commission and on margin, (2) the participation in syndicate and underwriting operations, and (3) the purchase and sale of securities for profit on its own account, which had always been an essential part of its business and was engaged in more extensively during the period 1925 to 1929 than theretofore (R. 33; Schafer R. 61).

Securities purchased by the partnership were acquired in expectation of a rise in the market price and for the purpose of resale, to any buyer, at a profit, and were not purchased for investment. Such transactions were entered on the partnership books in a so-called "Error Account" (the name having no significance). During 1929 the partnership purchased 107,500 shares and sold 92,500 shares of seventy-two different issues of securities, entered in the "Error Account." The number of such securities carried in that account at the close of 1929 was unusually large, due to the drop in the market and the inability to sell at a profit, but all but very few such shares were sold during 1930 (R. 33). The issue respecting the right to inventory securities is limited to those in the "Error Account."

From 1925 to 1929, inclusive, in accordance with its understanding of a ruling (R. 65-70, incl.) published by the Treasury Department in 1922 that stood continuously unquestioned for almost ten years, and as required by the rules of the New York Stock Exchange since about 1923, the firm inventoried the securities purchased and held by it for resale, at market values at the beginning and end of the year, and determined its income from this source upon the inventory basis (R. 33-34; Cornell R. 55-56; Schafer R. 59-60).

Since 1926 such inventory values were entered monthly on the firm's books (Cornell R. 54). The change of accounting method was made as a matter of business policy but with knowledge of the effect of the taxing statutes (R. 34). It is undisputed that the partnership was absolutely unable to ascertain whether it was making or losing money unless its securities were inventoried at market price both at the be-

ginning and end of the year (Cornell R. 56), and periodically (Schafer R. 58), and that *all* its securities were consistently so inventoried (Cornell R. 54).

This method of computing the firm's income was accepted by the Commissioner for all years up to 1929. For that year, when he came to audit the firm's return in 1931, he denied the partnership the right to use the inventory basis in computing its income on the ground that the firm was not a "dealer in securities" with respect to the securities which it purchased and sold for its own account that had remained unsold at the beginning and end of the taxable year.

His action resulted in increasing the firm's income for 1929 by the amount of $511,667 (in certain prior years such action would have decreased the firm's income) and consequently increased substantially the taxable income of each of the partners. Based on such increases to the firm's and to the individual's incomes, the Commissioner determined tax deficiencies for 1929 against these petitioners in the respective amounts of $33,329.20, $33,423.09 and $32,687.97.

Against these determinations of the Commissioner, petitioners appealed to the Board of Tax Appeals, which affirmed. From the decisions of the Board of Tax Appeals petitioners appealed to the Court of Appeals of the District of Columbia. That Court affirmed the Board's order, expressly refusing to follow prior decisions of identical issues by the Courts of Appeal for the Second and Third Circuits in cases admittedly indistinguishable upon their facts from the instant procedings (see R. 83-84).

Specification of Errors.

The Court of Appeals of the District of Columbia erred:

(1) In failing to hold that the use of inventories in 1929 by the firm of Schafer Bros. with respect to the securities it bought and sold for profit on its own account was essential in order clearly to determine the income of the firm, and consequently the income of each of these petitioners, in accordance with the best accounting practice, with the require-

ments of the Bureau of Internal Revenue, and with the rules of the Stock Exchange.

(2) In failing to hold that the firm of Schafer Bros. was a "dealer in securities" in 1929 as to those securities which it bought and sold for profit on its own account, and as such entitled to determine its income for 1929 upon the inventory basis.

(3) In failing to hold that respondent was precluded from arbitrarily changing a material factor in computing the firm's income for 1929, by a ruling made almost two years after the close of the taxable year at issue and more than one year after the firm and the petitioners had filed income tax returns as required by law. As will be shown, respondent's ruling made late in 1931 was exactly contrary to his prior ruling on the identical point that had been in effect unchallenged since 1922.

POINT I.

The statute entitles the partnership to the use of inventories in order clearly to determine its income in accordance with the best accounting practice in the trade or business.

For many years, including the taxable year, the purchase and sale of securities for its own account had been an important and integral part of the firm's business.

So as to determine the firm's profit or loss from its trading operations, it was essential to inventory its securities periodically at market. It would seem manifest that their cost basis would be positively misleading in determining the firm's periodical profit or loss in respect of the securities it owned, as is established by the undisputed testimony and of which this Court might well take judicial notice. The result of any such effort is graphically portrayed by the undisputed testimony of Edward Schafer (R. 58) to the effect that cost was meaningless; that if the market were up

a man who did not inventory his securities could conceal his profits; if it were down, he might be "broke" in fact, if solvent in name.

The firm was concluded by the rules of the New York Stock Exchange, which had consistently for many years prior to the taxable year required its member firms periodically to inventory their securities. It follows that securities were consistently taken up at market not only by Messrs. Schafer Bros., but also by every other firm similarly engaged, so that the periodical taking of inventories in respect of securities held *by all Stock Exchange firms* is essential to conform to the best accounting practice and most clearly to reflect the income within the precise language of Section 22c.

Since its securities were taken up monthly by the firm at inventory values on its books, such inventory values would be so reflected on its books at the beginning and end of each income tax taxable year. We accordingly submit that the annual income could not clearly be determined to conform to the best accounting practice, except by the method so adopted, and that this Court has given affirmative approval to the stand we take, as in *U. S. Cartridge Co.* v. *United States* (1932), 284 U. S. 511, where the Court said, at page 520:

> "Gains or losses must be accounted for in the year in which they are realized. The purpose of the inventories is to assign to each period its profits and losses. *Lucas* v. *Structural Steel Co.*, 281 U. S. 264, 268. The tax laws are calculated to produce revenue ascertainable and payable at regular intervals. Otherwise it would not be practicable to devise methods of accounting, assessment or collection capable of operation. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 365. The taking of petitioner's inventories at market value was essential to a proper disclosure of its financial position."

The inventory basis has been determined to be required by the best accounting practice in the same business, in *Estate of Hall*, 29 B. T. A. 1255, 1258, aff'd *sub nom. Comm.* v.

Stevens (2nd C. C. A., 1935), 78 Fed. (2d) 713, where the Board said (with respect to a firm engaged in the same type of business as Schafer Bros.):

> "It was customary in the trade or business of dealers in securities to inventory securities on hand at the end of each year at the market price. This method conformed to the best accounting practice in that trade or business. Dealers in securities follow this method because their transactions occur on the market basis. Securities used as collateral in connection with loans from banks are also valued at market, and reports made to the New York Stock Exchange are on the basis of market value, as well as cost. The method of inventorying securities on hand at market would be used in the best accounting practice in a financial balance sheet."

Since the use of inventories is necessary in order clearly to determine the income of the firm, then under Section 22(c), Revenue Act of 1928, there appears to be no option in the matter—"inventories shall be taken"—their use is mandatory.

With this requirement Schafer Bros. complied. Over a period of years they consistently inventoried at market prices their unsold securities at hand, and used such inventories in computing annual profit and loss. The firm's practice in this respect consequently complied with the two tests relative to the use of inventories promulgated by respondent in *Article 102* of Regulations 74: *First,* the firm's inventory conformed to the custom and best accounting practice in the security business for financial balance sheets and for general accounting, and, *secondly,* it was consistent, which we agree with respondent to be of paramount importance.

We concede the distinction between the application of the inventory rule to a partnership with an established place of business, and the individual stock trader.

Schafer Bros. was engaged in the business of trading in securities. It was an essential part of the firm's activities. The firm had an established place of business and kept a full set of books to reflect its trading operations in accordance with the requirements promulgated by the New York Stock Exchange, of which the firm was a member.

A partnership, even for tax purposes, is a quasi entity. The taxable income of its members is entirely derivative, being based on each member's share of the firm's income as a whole. Each partner is therefore concluded by the firm's method of keeping its accounts; he has no option as in the case of the individual trader.

The latter frequently keeps fragmentary records or no books at all. From practical considerations it would be difficult, if not impossible, for the Commissioner to permit him the use of inventories.

Where, however, the partnership as such not only values its securities periodically at market, but is required to do so by the rules of its Association in order most clearly to reflect its income in accordance with the best accounting practice, the use of inventories in computing the partnership income, as such, is mandatory upon the Commissioner and should be enforced by the Courts.

This first point of our brief is not directly concerned with the question whether the partnership was or was not technically a "dealer" within the provisions of Section 105 of Regulation 74.

Our previous argument is directed to the mandatory scope of the statute itself, the effect of which cannot be whittled away by any regulation in derogation thereof.

We also maintain, and hereby urge—

POINT II.

The partnership was a dealer with respect to the securities purchased with the view to sale at a profit, and was empowered by the respondent's regulations to inventory the securities in its "Error" account.

Article 105 of Regulation 74, heretofore quoted at pages 3 and 4, has been in effect in identical language since the Revenue Act of 1918 was enacted, under all Acts including that of 1928, except for the elimination for the Regulation in 1926 of a comma, hereinafter discussed.

Under that Article, one who maintains the right to be classified as a dealer in securities must comply with nine specific requirements. As summarized by the Court below (R. 85):

> "The regulation is that a dealer in securities, with an established place of business, regularly engaged as a merchant in the purchase of securities, not for investment, but for resale to customers with a view to gain and profit, is entitled to have his income computed on inventories."

Analysis of Article 105.

Detailed analysis of Article 105 discloses the following prerequisites to classification as a dealer in securities as that term is defined in the Regulations:

(1) "* * * a description of the method employed shall be included in or attached to the return * * *."

(2) "* * * all the securities must be inventoried by the same method * * *."

(3) "* * * such method must be adhered to in subsequent years * * *."

(4) "* * * a dealer in securities is a merchant of securities, whether an individual, partnership or corporation * * *."

(5) "* * * with an established place of business * * *."

(6) " * * regularly engaged in the purchase of securities and their resale to customers * * *."

(7) "* * * that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom * * *."

(8) "* * * If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment * * *."

(9) "Taxpayers who buy and sell or hold securities for investment or speculation (no comma) and not in the course of an established business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule."

We contend that Schafer Bros. complied with all the foregoing prerequisites, and the Court below has agreed with that contention as to the majority of such prerequisites.

It has tacitly accepted the expressed views of the Courts for the Second and Third Circuits (affirming 29 B. T. A. 1255 *sub nom. Estate of Hall*) in their decisions in *Commissioner* v. *Stevens* (1935), 78 Fed. (2d) 713, and *Commissioner* v. *Charavay* (1935), 79 Fed. (2d) 406, which held to be without merit as a preclusion to the use of inventories (1) the failure to disclose *on the return* a description of the method employed.* The Court for the Second Circuit reaffirmed this view in its decision in *Vaughan* v. *Commissioner,* decided August 10, 1936, not yet reported, but found in paragraph 9446, C. C. H. Tax Service.

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*We may be permitted to state that the method employed *was* disclosed and was known to respondent. Agents of respondent examined the firm's return—see notation "Field Audit" stamped on the face of the return, signifying that Schafer Bros.' books of account and records of its business for 1929 were examined by a Revenue Agent (R. 62 A)—and the deficiency notices herein show that respondent did have actual knowledge of the method employed (R. 10, 18, 27), before any deficiency was asserted.

The Court below recognized that Schafer Bros. (2) inventoried all its securities by the same method, (3) adhered to that method in all subsequent years after its adoption, (5) had an established place of business, and (6) engaged regularly in the purchase of securities, not for investment, but for resale at a profit.

Basis of Decision by the Court Below.

But although the Board *found as a fact* (R. 33, line 3) that "the partnership was a dealer and merchant of securities on commission and on margin" and the Court below found that the firm "was licensed to do a stock brokerage business, which we assume would include buying and selling on commission and *dealing* generally in what are popularly known as marketable securities" the Court based its conclusion on the untenable premises that the firm (4) was not a "merchant" of securities, (7) did not sell to "customers," (8) that its trading activities were a "branch" of its business, and (9) that its purchases and sales were "speculations."

Lower Courts in Conflict.

In so holding the Court, as itself states, falls directly, and we maintain erroneously, into conflict with the decisions of the Courts of the Second and Third Circuits in the *Stevens* and *Charavay* cases above cited, frankly conceding, however, that this case is indistinguishable on the facts from those cases.

Stevens and Charavay were members of the brokerage firm of Stevens & Legg, as these petitioners were members of the firm of Schafer Bros. The firm of Stevens & Legg bought and sold securities for and upon order of its customers, as did Schafer Bros. It participated in syndicates and underwritings, as did Schafer Bros. It was a specialist as to certain stocks, as was Schafer Bros. Stevens & Legg also bought and sold securities for its own account, making its purchases from or through other brokers on the Exchange, making its sales the same way, all exactly as did Schafer Bros.

Yet the Courts of the Second and Third Circuits decided that, as to securities thus bought and sold for that firm's own account, it was a merchant, that the brokers through and to whom it sold were its customers, and that such transactions were consummated, not as speculations, but "with a view to the gains and profits that may be derived therefrom," with the resulting conclusions that the firm of Stevens & Legg was a dealer in securities and entitled to the use of inventories in computing its income. We rely upon those decisions as controlling of the case at bar.

The restriction imposed by the Court below is justified neither by statute nor the Regulations.

The views of the Court below would confine classification as a dealer in securities under the Regulations solely to underwriters and other original distributors of securities. No such restriction is evidenced nor attempted either by the statute or by the Regulations. Nor is there any reason for such a restriction which would favor such distributors over taxpayers *regularly engaged in the security business in all its phases* who make a practice of buying and selling for their own account.

We invite attention to the emphasis placed by Congress upon the activities of *an established business* in its definition of a "dealer" in securities contained in the Securities and Exchange Act of 1934 (Sec. 3[a]):

> "(5) The term 'dealer' means *any* person engaged in the business of buying and selling securities *for his own account, through a broker or otherwise,* but does not include a bank, or any person in so far as he buys or sells securities for his own account, either individually or in some fiduciary capacity, *but not as a part of a regular business.*" (Italics ours.)

Any concern regularly engaged in the business of trading in securities is a "dealer." A trader is a "dealer."

The term "dealer" has received considerable judicial consideration, and we respectfully invite attention to the term as judicially construed, in "Words and Phrases" (First Series, Vol. 2, pp. 1859 *et seq.;* Second Series, Vol. 1, pp. 1222 *et seq.;* Third Series, Vol. 2, pp. 811 *et seq.;* Fourth Series, Vol. 1, p. 699).

The essential attribute of a dealer, as so defined, consists in his reliance upon favorable fluctuations in the market for the commodity or security.

> *Comm.* v. *Vetterlein* (Pa., 1906), 63 Atl. 192, at p. 193 (214 Pa. 21).

Accord: In re I. Rheinstrom & Sons Co. (D. C. Ky., 1913), 207 Fed. 119, where the Court at page 136 defined a "dealer" as:

> "* * * one who buys to sell again. He stands intermediately between the producer and the consumer, and depends for his profits, not upon the labor he bestows on his commodities, but upon the skill and foresight with which he watches the markets."

He is not a processor but a trader. See *State* v. *Rosenbaum* (Conn., 1907), 68 Atl. 250, 80 Conn. 327, where the Court said at page 251:

> "* * * A dealer is one whose business it is to buy and sell as a merchant, shopkeeper, or broker—a trader. Century Dictionary. A trader is one who makes it his business to buy merchandise, goods, or chattels to sell the same at a profit. Bouvier, Law Dictionary."

So, in *In re Hemming* (D. C. Miss., 1931), 51 Fed. (2d) 850, the Court said at page 851:

> "The words 'dealer' and 'trader' are synonymous; 'dealer' being one whose business is to buy and sell as merchant, shopkeeper, or broker, and 'trader' one

> making business of buying merchandise, goods, or chattels to sell at profit. A dealer is not one who buys to keep or makes to sell, but one who buys to sell again, a middleman between manufacturer or producer and consumer."

Accord: White Mountain Fur Co. v. *Whitefield* (New Hamp., 1914), 91 Atl. 870, where the Court drew an interesting distinction in holding that the plaintiff would not be a "merchant" of foxes if he purchased them with a view to selling their increase or their pelts, proceeding (at p. 872):

> "The question is: How does the plaintiff expect to make its profit, by buying and selling foxes, or by raising foxes and selling them."

The term "merchant" implies a dealer with an established place of business.

Although we do not contend that the terms "dealer" and "merchant" are necessarily synonymous, we beg leave to emphasize the distinction that is implicit not only in the general conception of the terms but in the Regulations themselves. *A "dealer" becomes a "merchant" when he acquires an established place of business for his trading activities.* Judicial sanction for our contention is contained in *Kansas City* v. *Ferd, etc., Co.* (Mo., 1903), 73 S. W. 302, 303, 98 Mo. App. 590, where the Court said at page 303:

> "* * * It does not follow, because a merchant is a dealer, that a dealer is also a merchant. A merchant must have a store, stand, or other place where he sells his goods. A dealer need not have such store, stand, or place to keep and sell his goods. He may buy and sell without such aids to his business."

Accord: Brown v. *Commonwealth* (Va., 1900), 36 S. E. 485, the Court saying at page 486:

> "A merchant's license contemplates that the merchant is to have a fixed place of business within a county or city,—a store or shop for the sale of goods. This is the common acceptation of the term as given in 2 Bouv. Law Dict., p. 155."

So a certain degree of continuity and volume would also appear to be requisite for a dealer also to be classified as a merchant. Both prerequisites are met by the record herein.

Although we believe the above qualifications of these terms to be strictly correct, there is respectable authority for failure to differentiate at all between the attributes of a dealer and a merchant. Thus, in A. R. R. 755, *I-1 Cumulative Bulletin 225* (R. 65-70), upon which petitioners relied in inventorying the firm's securities, respondent adopts the following definition given in Webster's New International Dictionary:

> "The term 'merchant' * * * includes 'any one making a business of buying and selling commodities,' 'a trafficker,' 'trader' or 'one who trafficks on a large scale.'"

We have no quarrel with the line of cases denying classification as a dealer in securities to parties engaged in trading in securities as a spasmodic or sole enterprise, as distinguished from an integral activity of a general Stock Exchange business as was the case with Stevens & Legg and with Schafer Bros.

Illustrative of such decisions is *Seeley* v. *Commissioner* (1935), 77 Fed. (2d) 323, decided by the Circuit Court for the Second Circuit (and distinguished by the same Court in its later decision in the *Stevens* case, *supra*), wherein it was held that a floor trader, not engaged himself in a general security business, could not qualify as a dealer in securities in respect to his personal trading ventures.

A further illustration is afforded by *Wilson* v. *Commissioner,* 76 Fed. (2d) 476, wherein it was held that the taxpayer, who was merely a selling agent for a securities firm, having no established place of business of his own, was not himself a dealer.

Adirondack Securities Corp. v. *Commissioner,* 23 B. T. A. 61; *Northeastern Surety Co.* v. *Commissioner,* 29 B. T. A. 297; and *Oil Shares Incorporated* v. *Commissioner,* 29 B. T. A. 664, complete the list. In those cases the taxpayers were denied classification as dealers in securities because they engaged in trading on their own accounts, not as a part of

a general business in securities, but as sole and distinct ventures.* The foregoing decisions all contain a fundamental factual distinction from the case at bar which accentuates the soundness of the Court's views in the *Stevens* case. A taxpayer who buys and sells securities does not thereby become a dealer in securities. But where, as here, a taxpayer engaged in the general security business with its numerous phases, already clearly a dealer within the meaning of the Regulations as to some of its activities, buys and sells securities for its own account for profit as an integral part and activity of its general business, it is likewise a dealer as respects its trading activities. Its securities are bought for resale to *any* customer at a profit. Its customers are those who buy from it, whether brokers, upon sales made through the Exchange, or other buyers. So the Court held in the *Stevens* case, and we contend correctly.

The effect of the decision below is to attempt a segregation, both actual and accounting, of the correlated and inseparable functions as dealer, broker and underwriter engaged in by this firm as essential activities of its general securities business. Some of the difficulties and resulting confusion which would arise from such attempt are pointed out by the Securities and Exchange Commission in its recent report to the Congress. (See "Report on the Feasibility and Advisability of the Complete Segregation of the Functions of Dealer and Broker," June 20, 1936, Government Printing Office.)

The buying and selling of securities was an integral part of the partnership business.

We challenge the view expressed by the Board and adopted by the Court below to the effect that the buying and selling by Schafer Bros. for its own account was a separate branch of its business and may be so treated for tax purposes.

* But see *Harriman National Bank* v. *Commissioner*, 43 Fed. (2d) 950, where the bank was held to be a dealer as to securities bought and sold for its own account, an activity which had long been an integral part of its general banking business.

Opposed to that is undisputed testimony that such trading was an *essential part* of the firm's business in 1929 and for fifty years before (R. 61) and the Board's own findings (R. 33), particularly as respects the years 1925 through 1929. Naturally the firm's own trading was kept separate on its books; its own purchases and sales were not commingled nor confused with the orders it executed as brokers for its clientele.

Naturally, also, this firm, as broker, trader and dealer, had varied business activities. But for more than fifty years buying and selling securities for the firm's own account had been an essential part of its business. If such an activity is not an "integral" part of a business nothing can be. As well to say the keeping of accounts, the billing of customers, the buying of supplies, are *separate branches* of a business as to hold separate a continuous activity initiated with the founding of the firm.

The buying and selling of securities was carried on from the same place of business, under the same direction and management and simultaneously with the other business activities of the firm. We respectfully submit it must be held to be an essential, integral part of the firm's business as a dealer in securities.

Elements of speculation in the purchase and sale of securities do not preclude classification as a Dealer.

The Court below has laid undue emphasis upon the speculative elements inherent in the firm's trading accounts.

May we, first and foremost, emphasize that if the element of speculation were held the determining factor, classification as a dealer would be inadmissible not only for any concern doing a business in securities, but to the very "merchant" whether of securities, commodities or merchandise, whom the Court below has sought to place upon a higher plane.

It goes without saying that not only an underwriter of securities, but the owner of a general store as well, engages in speculation. *Speculation is inherent in any business for*

the proprietor's own account. For so long as he owns property, whether real estate, commodities or securities, he is subject to the vicissitudes of the market.

This elemental and self-evident truth must lead to an interpretation of Regulation 105 in accordance with established experience.

The kernel of that Regulation as applied to the instant situation is contained in the last sentence, which we venture to repeat *in extenso* to emphasize our argument:

> "Taxpayers who buy and sell or hold securities for investment or speculation (no comma) *and* not in the course of an established business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule."

The purpose of that Regulation is two-fold:

1. It seeks to deprive the holder of securities for investment of the right to inventory, and justly so, since the investor has acquired his securities for the income they yield, and not to reap an appreciation of principal. Daily, monthly, or even yearly fluctuations in market value play no part in the transaction he has visualized.

2. The last sentence of Regulation 105 further limits the right to inventory to those engaged in an established business. The considerations necessitating such restriction have been previously adverted to and require no enlargement here.

The penultimate clause of that sentence is also highly significant in denying the right of inventory to *officers* of corporations and *members* of partnerships buying and selling securities *in their individual capacities.* These words reiterate the emphasis upon the predicate of an established business.

The two words "or speculation" in that sentence must, therefore, be deemed qualified by the succeeding words, "and not in the course of an established business."

Judge Learned Hand, in *Seeley* v. *Commissioner*, *supra*, has suggested the interpolation of a comma after the word "speculation" and changing the succeeding word "and" to the word "or."

Suffice to say that the Regulation has persevered in this form under every Revenue Act since that of 1918 with a rather significant exception that commencing with the Revenue Act of 1926 respondent *eliminated* a comma which did appear after the word "speculation" in Regulations 65, 62 and 45 in force under the Acts of 1924, 1921 and 1918. (See C. C. H., Consolidated Income Tax Laws, § 326, at p. 272.)

The elimination of the comma by Regulations 69, proclaimed under the 1926 Act, is carried over into Regulations 74, quoted *supra*. *If the comma belongs anywhere, it is before the words "or speculation."*

It follows that the element of "speculation" is immaterial from the strict language of the Regulations so long as the buyer and seller of securities "speculates" in the course of an established business.

But we do not limit our contention to the strict linguistic basis. We maintain that unless the privilege to inventory is withdrawn from any party who deals in commodities or securities for his own account, both the Commissioner and the Courts must allow for substantial elements of speculation in the transaction under scrutiny.

We accordingly maintain, prerequisites 2, 3, 5, 6 (including other brokers), 4 and 7 (in an established place of business), 8 (not for investment) of Section 105 having been met, that the Regulation can be construed to deny the right to inventory only (1) if the securites are acquired for investment, or (2) if not in the course of an established business.

The buying and selling of securities by the firm for its own account was not however "speculation," and the firm in so doing was not a "speculator."

In their emphasis that the partnership "was apparently a speculator and not a dealer within the regulations," the Board and the Court below had manifest reference to the fact that the firm bought securites in hope of reselling them at a profit. Of course it did. So does the underwriter of a fifty million dollar bond issue. So does a grocer who buys

a case of canned tomatoes. So does every entrepreneur who buys and sells any property, but that is not necessarily speculation.

Yet the market may change on tomatoes as well as on securities: the hoped-for profit may be lost to an underwriter or to a grocer as quickly as to a trader in securities. Somewhere there must be a line between the *trading* of a dealer and the *speculating* of a speculator, as that term is material here, since we know of no exception to the rule that all buying and selling is done in the hope of profit.

We maintain this firm is found on that side of the line with the *dealers,* not the *speculators;* that its buying and selling of securities was *trading,* not speculating—"with us, it was a trading proposition" (Cornell R. 57). The firm *was not buying on margin* as was the taxpayer in *Hammitt* v. *Commissioner,* 79 Fed. (2d) 494. That fact serves sharply to distinguish the case now at bar from the *Hammitt* case and points a distinction here, since the Court below considered marginal trading as speculation.

Here, the securities were purchased outright: paid for in full. This firm bought stocks and put them in its portfolio, just as an underwriter purchases bonds, just as the grocer buys tomatoes; and put them on their respective shelves, for resale at a profit "to any customer." (Another broker is a customer—*Commissioner* v. *Stevens, supra.*) The securities could have been sold to anyone who would buy, either at private sale or through the Exchange.

"Speculation" infers a great risk on a small stake; a legalized "gamble" perhaps. "Dealing" or "trading" infers a normal buying and selling on a sound basis. Both are done in hope of profit, of course, but in "dealing" or "trading" both risk and profit are smaller, sounder, more normal.

The conception of a dealer for which we contend is sustained by the "wash sale" provision of the Revenue Act of 1928 and the Commissioner's Regulations thereunder.

As further evidencing the correctness of the decision in the *Stevens* case, we invite attention to the evident intention

of Congress to enact the so-called "wash sale" provision as a corollary to the inventory privileges granted dealers in securities—a circumstance alluded to by the Court below in its opinion (R. 88).

The Commissioner, by his Regulations (Article 661 of Regulations 74), interprets Section 118 of the 1928 Act as follows:

> "A taxpayer, other *than one in the trade or business of buying and selling securities,* cannot deduct any loss claimed to have been sustained from the sale or other disposition of stock or securities, if within 30 days before or after the date of such sale or other disposition he has acquired (otherwise than by bequest or inheritance), or has entered into a contract or option to acquire, substantially identical property, and the property so acquired is held by the taxpayer for any period after such sale or other disposition. * * * This provision is designed to prevent a taxpayer who owns securities, *other than one in the trade or business of buying and selling securities,* from claiming as a deduction in computing net income the so-called 'loss' sustained from a sale of securities which is immediately followed or immediately preceded by a purchase of substantially identical securities." (Italics ours.)

No occasion for making the exception in question should arise unless the excepted classification of taxpayers were permitted to inventory their securities.

The criterion to be applied with respect to inventories as well as the "wash sale" provision is, therefore, whether the taxpayer is engaged as a business in the purchase and sale of securities and, for this purpose, an established place of business and evidence that purchases and sales of securities are an essential part of the taxpayer's business, are necessary factors.

In this connection we invite attention to the testimony of Mr. Edward Schafer (R. 59). The partnership herein was not within the "wash sale" provision. It could have sold the securities in the "Error Account" and repurchased the same securities the following moment, but the sales would

have constituted closed transactions upon which a deductible loss would have been established. *It would be an absurd perversion of the Revenue Act to urge that a taxpayer who may establish his losses by a "wash sale" is compelled to go through the motions.*

Moreover, denial of the right of Schafer Bros. to use inventories would lead to confusion in accounting.

Respondent's determination would have required the partnership to adopt conflicting methods of bookkeeping for its securities.

Respondent has not attempted to disturb the firm's practice of inventorying at market securities held in its syndicate and participation operations. The extent of those operations is shown in Exhibit 1 (R. 63-65) for the years 1926 through 1929.

Since the operations last mentioned and the trading operations conducted in the "Error Account" were both essential parts of the business of the firm, the absurdity of carrying one group of securities at market and another group of securities at cost appears on its face, *particularly in the light of the Stock Exchange regulations.*

If the use of inventories is necessary in order clearly to determine the income derived from syndicates and participations, there is no rhyme or reason for denying the right to inventory with respect to the trading accounts which were entered into for precisely the same purposes and under substantially the same conditions as the syndicate and participation operations.

There may or may not be a distinction that, in the case of the trading accounts, the securities were purchased and sold *through* brokers, but that is an obviously immaterial factor, as was held in the *Stevens* case.

We accordingly submit that the definition of a dealer properly extends to any established firm "in the trade or business of buying and selling securities" as a part of a general se-

curity business and that the findings and evidence respecting the nature of Schafer Bros.' business impel the application of the inventory provisions of the Regulation.

POINT III.

Schafer Bros. were entitled to inventory their securities for 1929 in reliance upon the long-established Bureau practice of prior years and the expressed views of the Bureau on the subject and respondent is now precluded from retroactively changing the basis of determining income.

The evidence shows that the partnership, in inventorying its securities, relied on a Ruling made in or about 1922 as respects the right of a trader in securities to use inventories (R. 55-56, 59-60). This Ruling was published as the opinion of the Committee of Appeals and Review, A. R. R. 755, I-1 C. B. 225, found as Exhibit 2 for Identification, at pages 65 to 70 of the Record.

The Committee on Appeals and Review was a reviewing group *within* and *a part of* the Bureau of Internal Revenue, established by the Commissioner himself. Its duties were to review the conclusions of other sections and officers of the Bureau respecting specific issues and cases and its rulings thereon represented the final decision *of the Bureau,* thereafter serving as guides both to the Bureau and to taxpayers (*Klein, Federal Income Taxation,* 36: 6(b): Article 1006 (A. R. M. 219), III-1 C. B. 319).

A. R. R. 755, when issued in 1922, was, therefore, the final decision of the Bureau upon the issue here involved, and was cited with approval by the Bureau in 1923 in Income Tax Unit Ruling (I. T.) 1818 II-2 C. B. 39. *It remained undisturbed by the Bureau until 1931.* It constituted an instruction to this firm to inventory the securities it owned. In 1923 the New York Stock Exchange passed it on to its members by requiring them to inventory their securities, and the firm complied with both instructions.

The ruling on which the partnership relied determined that a trader engaged in business as a buyer and seller of securities with the purpose and expectation of resale at a profit within a short period of time, and not for the purpose of investment, would have the right to inventory securities held by him at market in the computation of his taxable income.

Neither the language of the statute nor the regulations of the Commissioner on the subject of inventorying securities have changed in any material respect since the above decision by the Committee on Appeals and Review, which covered the activities of that particular trader for the years 1918 and 1919. The Regulation in force under the Revenue Act of 1918 and subsequent Acts have remained identical with Regulations 74, Article 105, except for elimination of the comma after the word "speculation."

The consistent interpretation placed by the Commissioner upon the statute respecting inventories through the decision of the Committee on Appeals and Review in A. R. R. 755 and its later approval in I. T. 1818, on which petitioners relied, preclude the application of a contrary retroactive ruling after a period of nine years.

The Government must adhere to the interpretation established continuously since 1922, not only by reason of its own rulings, but even more by reason of its administrative practice of allowing the use of inventories. The evidence is uncontradicted that the partnership had predicated its income subject to tax by the use of inventories at all times since 1924 without any effort by the Commissioner to enforce any change. In fact, with the ruling of the Committee on Appeals and Review before it as the only guide for interpretation of the statute, the firm of Schafer Bros. was compelled to inventory the securities in its trading account. Any other course of procedure would have been legally erroneous at the time the firm's income tax return for 1929 was required to be filed.

The practice followed by the partnership was developed and promulgated under the Revenue Act and Treasury Regulations as far back as 1918 and has been ratified, confirmed and acquiesced in by the enactment of statutes and the promulgation of regulations *employing the same language as the earlier enactments.*

Where a statute has been construed by a judicial, legislative, executive or departmental authority and has been re-enacted in the same or substantially the same terms, the Congress is presumed to have been familiar with its construction and to have adopted such construction as a part of the law.

This Court has consistently held that statutory interpretations by executive, administrative or departmental authorities, such as the Treasury Department, in relation to the Tariff Act (*National Lead Co.* v. *United States* [1919], 252 U. S. 140), the Interstate Commerce Commission (*New Haven R. R.* v. *Interstate Commerce Commission* [1905], 200 U. S. 361), a State tax board (*Copper Queen Mining Co.* v. *Arizona Board* [1906], 206 U. S. 474), tariff authorities (*United States* v. *Baruch* [1911], 223 U. S. 191), immigration authorities (*Nagle* v. *Loi Hoa* [1927], 275 U. S. 475), and the Postmaster General and the accounting officers of the Treasury (*United States* v. *Alabama R. R. Co.* [1891], 142 U. S. 615), will be followed by the Courts where the same provision of the statute is adopted or re-enacted for many years without change.

In *Edwards* v. *Wabash Ry. Co.* (C. C. A., 2nd Cir., 1920), 264 Fed. 610, which involved the application of a stamp tax to certain exchanges of stock certificates, the Court said at page 618:

> "* * * Congress, by re-enacting the act without substantial change in the provision now under consideration, *adopted the construction which the Treasury Department for 15 years had placed upon it.*" (Italics ours.)

The first attempt by respondent to refute the controlling effect of A. R. R. 755 came with his promulgation of General Counsel's memorandum (G. C. M. 9656), which appears in X-2 Cumulative Bulletin 127, issued during the latter part of 1931.* This was a year and a half after the partnership and the individual partners were required to file and did file their income tax returns for the year 1929. They were compelled to rely upon A. R. R. 755 (approved by I. T. 1818), which was the only binding interpretation of the law and regulations in force up to that time, *and so relied to their detriment by failing to avail themselves of the "wash sale" provisions (see Edward Schafer, R. 59).*

These considerations the Court below brushes aside (R. 87-88)—even though granting that "the Bureau's willingness to leave undisturbed the practice until 1929 was induced by the larger tax accruing to the government"—on the ground that equity cannot correct a wrong done a citizen by government, however shocking. The inequities are so apparent we need not argue them. But we respectfully submit that mere gross injustice is not the only factor to sustain our contentions.

Here, respondent, by statute, was authorized to prescribe the use of inventories in such situations as, in his opinion, they might be necessary to conform to the best accounting practice and to most clearly reflect income. In Articles 102 and 105 of his Regulations he named such situations. A. R. R. 755 and I. T. 1818 interpreted those provisions of the Regulations for the guidance of respondent's agents and taxpayers as well. Those Regulations and those interpretive rulings stood unquestioned for almost ten years through enactment by the Congress of three or more successive Revenue Acts, thereby receiving Congressional approval and, consequently, the force and effect of law.

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* That ruling had reference to an individual who maintained an office for the purchase and sale of securities as his sole vocation. On its face the ruling should have no application to a partnership that purchased and sold securities in connection with its general securities business. Furthermore, the definition of "merchant" adopted by that ruling was predicated upon the archaic conception of a merchant under the ancient bankruptcy acts, and invokes the narrower comparative of a "tradesman" rather than the broader and more modern simile of a trader with an established place of business. The ruling also limits the term "dealer" to one who buys and sells *for the account of others*, which is manifestly incorrect, since such a person would be a broker or agent, and not a principal.

Respondent in now thrusting upon these petitioners and their firm a new basis for computing income is not attempting merely to change his interpretation of the law, as the Court below infers, but is in reality attempting to change what has become the law itself.

No decision of this Court or of any other judicial body impelled the Commissioner's *volte face* as respects a partnership with an established business.

Since he permitted his interpretations to stand until they assumed the strength of law, and since these petitioners relied thereon to their detriment in computing their incomes and that of their firm for 1929, on a basis thereby directed and consistently used, respondent is estopped from arbitrarily imposing upon them a new basis of computation which he has discovered to be financially more advantageous.

CONCLUSION.

We respectfully submit that the assignments of error be allowed, that the decisions of the Court of Appeals and of the Board of Tax Appeals be reversed, and that the distributable income of the petitioners from the partnership of Schafer Bros., and their corresponding income tax liability for the calendar year 1929, should be redetermined on the basis of inventorying securities owned by the partnership at the beginning and end of the calendar year 1929 at the then prevailing market values thereof, as computed at the trial by stipulation (R. 51).

Respectfully submitted,

EUGENE UNTERMYER,
EDGAR J. GOODRICH,
Counsel for Petitioners.

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Supreme Court of the United States

OCTOBER TERM, 1936.

ALGERNON S. SCHAFER, Petitioner, vs. GUY T. HELVERING, Commissioner of Internal Revenue, Respondent.	No. 24.
EDWARD SCHAFER, Petitioner, vs. GUY T. HELVERING, Commissioner of Internal Revenue, Respondent.	No. 25.
LEONARD SCHAFER, Petitioner, vs. GUY T. HELVERING, Commissioner of Internal Revenue, Respondent.	No. 26.

REPLY BRIEF FOR PETITIONERS.

I.

The provisions of the statute confirm the construction of the regulations for which we contend.

Since the Commissioner has prescribed uniform regulations under Section 22 (c) of the statute, under the authority

judicially approved in *Lucas* v. *Structural Steel* Co. (1929), 281 U. S. 264, at p. 268, the application of those regulations to a given state of facts becomes a judicial question.

See:

Russell v. *Commissioner* (C. C. A., 1st Cir., 1930), 45 Fed. (2d) 100, at p. 101;

Seeley v. *Helvering* (C. C. A., 2nd Cir., 1935), 77 Fed. (2d) 323.

The fountainhead of the Respondent's regulations respecting inventories remains the statute itself, the language of which is paramount in arriving at a proper construction of Article 105.

Whether or not the statute compels the Commissioner to allow for use of inventories in a proper case, once he has proceeded to prescribe his regulations they must conform "as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income."

We accordingly urge that any regulation, once adopted by the Respondent, must be construed in the light of the statute's expressed provisions.

In attacking the problem herein presented, Respondent is therefore faced at the outset with the requirement of the New York Stock Exchange and the uniform practice adopted for years by Schafer Brothers, together with the undisputed evidence that the partnership, in the course of its business, could only determine its periodical income and financial condition from the market values of the securities owned by it from time to time.

Petitioners do not contend that the inventory section is a "relief" provision. All they ask is that the law and regulations be applied to them in such manner as most clearly to reflect the income of the firm's business.

See *Commissioner* v. *Stevens* (C. C. A., 2nd Cir., 1935), 78 Fed. (2d) 713, where the Court said at page 714:

> "Congress did not vest the Commissioner with powers by administrative requirement to deprive

dealers of the right to use inventories which are necessary to clearly determine its income where, as here, the actual method employed conformed, as nearly as possible, to the best accounting practice in the trade and most clearly reflected income, and where there has been a substantial compliance with the statute and regulations. United States v. United Verde Copper Co., 196 U. S. 207, 25 S. Ct. 222, 49 L. Ed. 449; In re Clicquot Club Co. v. United States (D. C.), 13 F. (2d) 655."

II.

The firm has complied with all the approved requirements of Article 105 to warrant its classification as a dealer.

There is No Question of Insufficient Findings.

The findings of the Board (R. 33) establish in so many words that the partnership bought and sold securities for its own account "as a part of its business activities." This should dispense with any possible inference Respondent may have endeavored to convey that the transactions in the "Error Account" were sporadic or in the nature of a "sideline."

The Board has also found (R. 33) that the partnership was "a dealer and merchant in securities on commission and on margin."

In executing orders on commission, the firm was an agent and could not be a dealer. So, in carrying accounts on margin for its customers, the firm was a pledgee and not a dealer.

Much of Respondent's argument arises from the confused use, often in respectable quarters, of the term "dealer." A dealer is always of necessity a principal.

Since the Board has found that the firm was a dealer in securities, its activities in that capacity are necessarily exclusive of its operations as Stock Exchange brokers. The application of that term to its activities is consequently limited to its operations as a principal, and those operations comprised, besides its participation in syndicate and under-

writing operations, the purchase and sale of securities for profit "as a part of its business activities."

Respondent is therefore in no position to assert that the findings are insufficient to justify the firm's classification as a dealer if the facts establish that status as a matter of law.

There is No Warrant in the Statute or Regulations For Respondent's Contention That a Dealer Must Hold Himself Out to the Public That He Has Securities For Sale.

Respondent predicates his entire argument against the firm's compliance with the prerequisites classified as Nos. 4, 6 and 7 of our memorandum-in-chief, upon the absence of elements establishing a so-called "holding out."

Nothing in the language of those requirements in Article 195 envisages a factual representation that the "dealer" has securities for sale, aside from the daily activities of any trader in securities who offers his wares for sale to anyone at a price.

Respondent's effort to predicate his position upon the use of the word "merchant" is sufficiently answered by the repeated judicial definitions of that term, set forth at some length in our memorandum-in-chief, by which *a merchant has been held to be any non-processing dealer or trader provided he has an established place of business from which his sales are conducted.*

We submit that this is precisely why the last sentence of Article 105 lays stress upon the existence of an established business, and a place from which that business is conducted.

Many a dealer in merchandise sells through agents and may never know the identity of the ultimate purchaser, but remains a merchant notwithstanding.

To draw a closer analogy, it is common knowledge that the underwriter or wholesaler of a bond or stock issue will deal in large part through brokers and houses of issue, to whom is allowed a commission for the services rendered in distributing the securities among the latter's clientele.

That very underwriter may have no more knowledge of the ultimate purchaser than had Schafer Brothers respecting the identity of those who purchased the securities they offered for sale, but we are confident that Respondent will not deny the application of Article 105 to such an underwriter.

We accordingly submit that the views of the Second Circuit in the *Stevens* case correctly interpreted the requirement of "sales to customers" to embrace any party who was willing to buy from the taxpayer firm.

The Firm's Trading Activities Were Conducted as a Part of Its General Business Activities.

Our analysis of the findings (this brief, p. 3) establishes that the firm's trading activities were a part of its business and not a side line. Since elements of speculation enter into the activity of every dealer, or one who depends for his profits (whether in merchandise or securities) on the fluctuations of the market (see our memorandum-in-chief, pp. 15, 16), the vital element of Prerequisite 9, arising under the last sentence of Article 105, is the factor of an established business, and place of business, to enable such dealer or trader to fall within the definition of a "merchant."

We coincide in Respondent's view that the sentence was ineptly phrased to maintain his contentions on this appeal, and invite attention to the change in phraseology appearing in his regulations adopted under the *subsequent* Revenue Acts of 1932 and 1934, analyzed herein at a later juncture.

Our Contentions Respecting the "Wash Sale" Provision Are Made in the Light of Respondent's Own Interpretation, as Approved by the Board of Tax Appeals.

We contend that any party who is exempt from the "wash sale" provision under Section 118 of the Law is so exempt because that same party would have the correlative right to inventory his securities. We contend that the words "one

in the trade or business of buying and selling securities," described in the Regulation interpreting Section 118, is necessarily a dealer in securities under Article 105 and entitled to inventory the same under Section 22(c).

One of the very authorities relied upon by Respondent, being *Donander Co.*, 29 B. T. A. 312, involved the right of a corporation that had been organized to take over the assets of a decedent's estate, to avail itself of the exception to Section 118 of the Revenue Act of 1928.

The Board, in holding that the exception to the "wash sale" provision was not properly invoked by the Donander Co., applied in its determination the rulings made *under the inventory provision of the Statute,* and determined in so many words that a "dealer in securities" under the inventory provisions occupied precisely the same status as "one in the trade or business of buying and selling securities" under Article 661 of Regulations 74, which interprets the exception to Section 118. (See 29 B. T. A., at page 314, from which it appears that the Commissioner, Respondent in that case, had taken precisely that position.)

In the later case of *Walter Thiele,* 32 B. T. A. 134, the Board held that an *individual trader on margin* might properly indulge in "wash sales" under Section 118, even for the admitted purpose of realizing income tax losses in 1929.

Respondent's strictures respecting the naivete of our contentions is sufficiently answered by his own position in the *Donander* case, as well as by the general application of the "wash sale" provisions, which would penalize the class of persons entitled to avail themselves of the inventory provisions who might sell and repurchase those securities within thirty days, unless an exception were enacted in their favor as has been accomplished in Section 118 of the 1928 Act.

The Effect of the Stock Exchange Regulation.

We do not contend that the Stock Exchange rule requiring its member firms to inventory their securities of itself binds the Federal tax authorities. The regulation and Schafer Brothers' compliance therewith is, however, persuasive evi-

dence that so much of the petitioners' income as was based upon the taxable income of the firm requires the use of inventories so as to conform as nearly as may be to the best accounting practice in their particular trade or business and as most clearly reflecting the firm's income, in the language of Section 22(c). Article 105 must, of course, be construed in such a manner as best to carry out the spirit of the statute.

Nor does this suit involve merely respective merits of accounting, since the right of any taxpayer to be classified in a particular manner for the purpose either of the statute or of the regulations remains at all times a judicial and not an administrative question.

The Decisions in the Stevens and Charavay Cases Were Not Predicated upon the Claim That Those Taxpayers Were Specialists.

Both of the taxpayers involved in the foregoing cases were members of the firm of Stevens & Legg. That firm was a specialist only in the securities of the New York Dock Company, but the courts nevertheless sustained the action of the Board granting the right to inventory securities of numerous other companies held by the partnership (see 29 B. T. A. 1260).

In the recent case of *Vaughan* v. *Commissioner*, the Second Circuit reaffirmed that the right to inventory approved in the *Stevens* case was not limited to the stocks in which that firm acted as specialists. (See I Prentice Hall, 1936, Federal Tax Service, ¶1509, at p. 1677).

The remaining authorities relied upon by Respondent appearing at page 11 of his brief either involved the attempt to inventory securities acquired *for investment* (*Adirondack Securities Corp.*), or the case of a surety company which was not engaged in the purchase and sale of securities as part of its general business (*Northeastern Surety Co.*), or where the taxpayer did not inventory its securities on its books and endeavored to do so thereafter when a more favorable tax situation seemed to invoke that practice (*Northeastern Surety Co., Oil Shares, Inc.*). The *Donander* case

has previously been discussed and, as stated, involved an estate holding company, which would scarcely appear to embrace the purchase and sale of securities as a business within its purview.

III.

The consistent practice and rulings of the Bureau and the language of its regulations under all Revenue Acts from that of 1918 through that of 1928 vest the interpretation of the regulations for which we contend with the force of law.

We do not maintain that the doctrine of estoppel may be asserted against a sovereign to preclude the exercise of a power inherent in its sovereignty. We do maintain that the facts of this case and the history of Article 105 of Regulations 74 and Regulations under predecessor Acts, as applied to Section 22(c) of the Revenue Act of 1928 (and the corresponding sections of predecessor Acts), impel the conclusion that the construction of the Regulation for which we contend has the force of law.

This Court said in *Fawcus Machine Co.* v. *United States* (1931), 282 U. S. 375, at page 378:

> "* * * The regulations were made pursuant to express authority (see §1309 of the Revenue Act of 1918). They are valid unless unreasonable or inconsistent with the statute. *United States* v. *Grimaud*, 220 U. S. 506, 517-518; *International Ry. Co.* v. *Davidson*, 257 U. S. 506, 514. They constitute contemporaneous construction by those charged with the administration of the act, are for that reason entitled to respectful consideration, and will not be overruled except for weighty reasons. *United States* v. *Moore*, 95 U. S. 760, 763; *Brewster* v. *Gage*, 280 U. S. 327, 336."

Due to Respondent's interpretation of Article 105, at variance with its language and particularly of its last sentence,

we have since been impelled to examine the Regulations promulgated by Respondent under the provisions of the two succeeding Revenue Acts, and take the liberty of inviting to the Court's attention that although Article 105 has been modified in Regulations 77, promulgated under the Revenue Act of 1932* (and also Article 22[c]-5 of Regulations 86, promulgated under the Revenue Act of 1934), *Respondent has at no time seen fit to amend Article 105 of Regulations 74 or any corresponding predecessor Regulations.*

Since the Revenue Act of 1928 is an enactment separate and distinct from the succeeding Revenue Act of 1932, the determination of Respondent respecting the use of inventories must be derived from within the four corners of the Regulations promulgated by him under the earlier Act. The only Regulation he has so prescribed is Article 105 of Regulations 74 which were promulgated by the Respondent with the approval of the Secretary of the Treasury and have the force of law. (See *Helvering* v. *New York Trust Co.*, 292 U. S., at p. 468.) This case is governed by the Act of 1928 and not by any prior or subsequent revenue law.

Even if Regulations 77 be construed retroactively, they can have application only to cases arising under the 1932 Act. (See *Manhattan etc. Co.* v. *Commissioner* [2nd Cir., 1935], 76 Fed. [2nd] 892, at p. 897; *Bamberger*, 27 B. T. A. 785, at p. 794.)

The modification by Respondent of the last sentence contained in Article 105 confirms our view that the predicate of an established business is a primary factor in the determination of who is a dealer in securities *under the Revenue Act of 1928.* It further confirms our view that Article 105 *of Regulations 74* reads as it was intended to read, and that a Stock Exchange house buying and selling securities in the course of an established business, even though the

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* The last paragraph of Article 105 has been changed to read:

"Taxpayers who buy and sell or hold securities for investment or speculation, *irrespective of whether such buying or selling constitutes the carrying on of a trade or business*, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule,"

the italicized words having been substituted for "and not in the course of an established business," as they appear in Article 105 of Regulations 74.

transactions involve elements of speculation, are dealers in securities within its language and intent.

Else, why make mention of the words "not in an established business," or lay stress upon the profits of officers of corporations and members of partnerships in their individual capacities?

And if the factor of an established business is not a determining element, why should respondent see fit, under a subsequent law, to lay stress upon the immateriality of that factor, in direct contradiction to the language of his Regulations under the Act by which this case is governed?

Respondent will doubtless rely upon *Helvering* v. *New York Trust Co.*, 292 U. S. 455, at page 468, which supports the thesis that mere *addition* of language does not necessarily indicate intention to change the law. The views of the Court in that case are, if anything, favorable to the contentions of the petitioners, in the light of this Court's holding in *Brewster* v. *Gage* (1930), 280 U. S. 327, at page 337, that a *change* in the language of a subsequent act (as distinguished from the addition of certain words) indicates that a change of law was intended and that such change will not apply retrospectively.

There has been no change in the language of Section 22(c) since the 1918 Act was passed. A very material change has, however, been made in the Respondent's Regulations promulgated since the passage of the Act of 1932.

His G. C. M. 9656 (our brief, p. 28), issued during the latter part of 1931, which was the first inkling that he would recede from A. R. R. 755, was no more a formal promulgation by the Commissioner with the approval of the Secretary than was his earlier inconsistent ruling.

Nothing in Section 22(c), as it read under any of the Revenue Laws, precludes periodical changes in the Commissioner's Regulations respecting inventories. The difficulty with Respondent's position is that no such change was ever made under the 1928 Act or under any preceding Act (except the elimination of a comma in the last sentence of Article 105, which favors the petitioners' interpretation).

It follows that a change in language of a regulation promulgated under a separate and subsequent law inevitably creates the inference that the language of Article 105, as it read under the 1928 Act, means what it says.

No extended argument is needed to establish the gross injustice resulting from the *volte face* of the Respondent as confirmed by the opinions below. Petitioners are, however, favored by the views frequently expressed by this Court that a doctrine of taxation at variance with pre-existing practice will not be retroactively construed.

See:

Nichols v. *Coolidge* (1927), 274 U. S. 531;
Brewster v. *Gage, supra.*

The evidence and findings that establish petitioners' reliance upon Respondent's uniform course of practice to their detriment are not in dispute. It necessarily follows that the Court must give retroactive effect to a material change in the effect of the statute, which is severely prejudicial to petitioners, if the views of the court below are to be sustained.

We accordingly rest confident that, notwithstanding the sometimes arbitrary results implicit in the taxing power, the facts of this case and the gross injustice involved, coupled with the uniform history of the statute and regulations, as they persevered until long after the event and the filing by petitioners of their tax returns, afford the force of positive law to Article 105 of Regulations 74 as promulgated under the 1928 Act, and to Respondent's consistent course of interpretation thereof.

IV.

Petitioners' contention denying retroactive effect to the Department's ruling made in 1931 is properly before the Court.

In reply to Respondent's contentions that the issue of retroactive effect was not presented in the petition for cer-

tiorari, we respectfully invite attention to the following quotations appearing:

(a) In the petition, at page 4:

> "From 1925 to 1929, inclusive, in accordance with a ruling published by the Treasury Department in 1922 that stood unquestioned for some nine years, and as it was required by the rules of the New York Stock Exchange, the firm inventoried the securities purchased and held by it for resale at a profit, at market values at the beginning and end of the year, and determined its income from this source upon the inventory basis.
>
> This method of computing the firm's income was accepted by the Commissioner for all years up to 1929. For that year, in auditing the firm's returns in 1931, he denied the partnership the right to use the inventory basis in computing its income on the ground that the firm was not a 'dealer in securities' with respect to the securities which it purchased and sold for its own account that had remained unsold at the beginning and end of the taxable year.
>
> This action resulted in increasing the firm's income for 1929 (in prior years such action would have decreased the firm's income) and consequently increased substantially the taxable income of each of the partners."

(b) In the specification of errors contained in the petition, at page 5:

> "2. In failing to hold that the use of inventories in 1929 by the firm of Schafer Brothers with respect to the securities it bought and sold for profit on its own account was essential in order clearly to determine the income of the firm, and consequently the income of each of these petitioners, in accordance with the best accounting practice, *with the requirements of the Bureau of Internal Revenue* and with the rules of the Stock Exchange." (Italics ours.)

(c) In the brief in support of the petition, at page 9:

> "Here, Schafer Brothers for a number of years had computed its income from purchase and sales of securities for its own account on the inventory basis.

> The sudden rejection of that basis in 1931 by the Commissioner for the taxable year 1929 and the use by him of the actual sales basis in computing the firm's income for that year resulted in an increase on paper in the firm's income of $511,667 over the amount disclosed by its tax return."

(d) In the brief in support of the petition, at page 12:

> "The sudden reversal of opinion by the Commissioner, in diametrical opposition to his practice of over nine years, was not impelled by any change in the Statutes or Regulations, since the above-quoted provision of the Revenue Act of 1928 and the appurtenant Regulation have stood substantially unchanged since the enactment of the Revenue Act of 1918."

Further attention is invited to the lengthy discussion afforded to the precise point by Judge Groner in the last two paragraphs of the opinion of the Court of Appeals for the District of Columbia (R. 89 [87] and 90 [88]).

In his discussion, the learned Justice lays stress upon the injustice involved and the resultant increase in petitioners' taxes for previous years from observing the consistent rulings of Respondent, as well as upon the petitioners' failure to avail themselves of the exception to the "wash sale" provision contained in Section 118 of the Revenue Act of 1928, equally by reason of such reliance.

We further submit that the intimations contained in the authorities cited by Respondent in the first paragraph of his Point III (his Brief, p. 20) involve discretionary limitations; that they do not affect the jurisdiction of this Court; and that the views expressed by Mr. Justice Harlan in *Donovan* v. *Pennsylvania Co.* (1905), 199 U. S. 279, where he said at page 292:

> "As this case is before us on writ of certiorari, we can dispose of all questions arising on the record,"

is a correct exposition of the jurisdictional factor.

Assuredly, nothing contained in Section 240 of the Judicial Code, as amended (U. S. C. A., Sec. 347), imposes any such

limitation as is contended for by the Respondent since that provision empowers this Court to require by certiorari

> "that the *cause* be certified to the Supreme Court for determination by it, with the same power and authority and with like effect as if the case had been brought there by unrestricted error or appeal."

We find no such limitations in the orders allowing certiorari in the several appeals herein (R. 93).

The extent of consideration afforded to the point in the opinion of the Court below should therefor impel this Court to resolve the issue of retroactivity in connection with the remaining related questions appearing from the record and petition herein.

The Question of Retroactivity Arises, However, in Connection with Construction of the Regulation and Does Not Present a Separate Issue.

The ultimate question in this case is the application to the facts and findings herein of Article 105 of Regulations 74. Interpretation of the Regulation in the light of the statute's language, and the effect to be given to the Commissioner's rulings, dovetail into the general question of how Article 105 shall be construed.

The course of interpretation ascribed thereto by Respondent, taken in the light of the subsequent change in language of the Regulation, all resolves itself in the last analysis to the judicial construction that this Court may afford to Article 105 of Regulations 74 as it read under the Revenue Act of 1928 and the Revenue Acts in force for the ten years next preceding.

This Court has frequently adverted upon the judicial effect afforded to long-established administrative practice, and for its views as recently as November, 1935, we beg leave to invite attention to *McFeely* v. *Commissioner*, 296 U. S. 102, at page 108:

> "The Commissioner has heretofore administered the section upon this theory. As respects the Revenue

> Act of 1921, he so ruled in 1923, and again in a very full memorandum in 1924. It was stated in briefs and at the bar that these rulings have never been cancelled or revoked, and the statement was not challenged. The repetition of the definition without material change in the subsequent acts, including that of 1928, amounts to a confirmation of the administrative interpretation."

In passing, we may observe that the above quotation was predicated upon rulings of the Income Tax Bureau, Office Decisions, and Opinions of Treasury Counsel (see footnotes 10 and 11 at p. 108), a factor that substantially impairs the force of respondent's claim (his brief, p. 22) that *Helvering* v. *New York Trust Company, supra,* limits the force of administrative rulings to Treasury Regulations or Treasury Decisions in the application of the doctrine we have just previously quoted.

CONCLUSION.

The decision below should be reversed.

Respectfully submitted,

EUGENE UNTERMYER,
EDGAR J. GOODRICH,
Counsel for Petitioners.

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63149—36

In the Supreme Court of the United States

OCTOBER TERM, 1935

No. 895

ALGERNON S. SCHAFER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 896

EDWARD SCHAFER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 897

LEONARD SCHAFER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 36–40) is reported in 32 B. T. A. 289. The opinion of the Court of Appeals (R. 84–90) is unreported.

JURISDICTION

The judgments of the Court of Appeals were entered March 2, 1936. (R. 90–92.) The petition for writs of certiorari was filed April 6, 1936. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, with respect to the purchases and sales of certain stocks, the brokerage firm of Schafer Bros. was a dealer in securities and entitled to make its return for the taxable year 1929 under the inventory method of accounting.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 22. GROSS INCOME.
>
> * * * * *
>
> (c) *Inventories.*—Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as

conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

> ART. 105. *Inventories by dealers in securities.*—A dealer in securities, who in his books of account regularly inventories unsold securities on hand either—
>
> (a) At cost;
>
> (b) At cost or market, whichever is lower; or
>
> (c) At market value,
>
> may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the Commissioner. For the purpose of this rule a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of re-

sale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation and not in the course of an established business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 34–36) may be summarized as follows:

During the taxable year 1929, and for several years prior thereto, the petitioners, under the firm name of Schafer Bros., conducted a general brokerage business with offices at 120 Broadway, New York. Leonard Schafer owned a seat on the New York Stock Exchange and was the floor member. Algernon and Edward were the office members of the firm. All three were actively engaged in the business. (R. 34.)

This partnership was a dealer and merchant in securities on commission and on margin, and in such capacity executed orders for purchase or sale of securities by its customers either on the Exchange, the Curb, or wherever the particular securities were listed. From 1925 through 1929, the partnership participated in a great number of syndicate and underwriting operations. Also, as a part of its business activities, but with no relation to its customers' accounts nor to the execution of orders for its customers, the partnership has

always, to some extent, bought and sold securities for its own account. (R. 34–35.)

Beginning in 1925 or 1926 and continuing through 1929 the partnership traded in securities for its own account much more extensively than had been its practice during 1925. Such trading was conducted through orders executed by Leonard Schafer or other brokers and had no relation or connection with the accounts of the partnership's customers, but were purchased in expectation of a rise in the market price and for the purpose of reselling, to any buyer, at a profit for the partnership's own account. Such securities were not purchased for investment. (R. 35.)

Sales of the securities were made through orders given Leonard Schafer or other brokers, and the identity of the purchasers was not known. Such purchases and sales were entered in the so-called "Error Account", which was an old account carried on the books of the partnership and used for its own transactions in securities. The name "Error Account" had no significance. (R. 35.)

During 1929, the partnership purchased 107,500 shares and sold 92,500 shares of 72 different issues of securities, entered in the "Error Account". The number of such securities carried at the close of 1929 was unusually large due to the drop in the market and the inability to sell at a profit but all except a comparatively few were sold during 1930 (R. 35).

In 1923, the New York Stock Exchange made a rule requiring its members to inventory securities for the purpose of certain Exchange questionnaires. Prior to 1925, the partnership had carried its own securities (as distinguished from those carried for customers' accounts) in the "Error Account" at cost, but beginning with that year and including 1929, it inventoried them at their fair market value both at the beginning and end of the year. Such change was made as a matter of business policy, but with the knowledge of the effect of the taxing statutes. (R. 35.)

The Commissioner determined that this partnership was not a dealer in securities with respect to those carried in the "Error Account" and that they must be carried at cost. Accordingly, he disallowed the use of inventories and increased the partnership's income by $511,667, the difference between the cost over the market value at the beginning and the end of the year 1929. (R. 36.)

The Board concluded, as to this branch of the partnership's business, that it was a speculator and not a dealer in securities within the meaning of the regulations, and approved the deficiencies found by the Commissioner. (R. 40–42.) The Court of Appeals sustained the Board's decisions. (R. 90–92.)

ARGUMENT

Pursuant to the broad grant of authority contained in Section 22 (c) of the Revenue Act of 1928, *supra,* p. 2, the Commissioner of Internal

Revenue has set out, in Article 105 of Regulations 74, *supra*, p. 3, the requirements which must be met before a person can, as a dealer in securities, use the inventory method of computing his income. These regulations have been approved as reasonable and as fairly carrying out the intent of the statute. *Seeley* v. *Helvering*, 77 F. (2d) 323 (C. C. A. 2d); *Wilson* v. *Commissioner*, 76 F. (2d) 476 (C. C. A. 10th). Moreover, their terms are plain. To be a dealer in securities entitled to use inventories, one must (1) be a merchant of securities, (2) have an established place of business, (3) be regularly engaged in purchasing securities for resale to customers at a profit, and (4) buy as a merchant for resale and not for investment or speculation. It is apparent that in determining whether a taxpayer meets these requirements, the primary question is one of fact. The courts have so treated it, and have held that if different conclusions may be reasonably drawn from the same undisputed facts, the findings of the Board are binding on the reviewing court. *Wilson* v. *Commissioner, supra.*

In the instant cases, the court below found that the findings of the Board were supported by substantial evidence, and upheld the conclusion that the petitioners were speculators, and not entitled to the use of inventories. The court pointed out that there was no evidence to show that the firm held itself out as having on hand securities for

sale on their own account to customers, or that they offered securities for sale in the sense that a merchant offers his stock in trade for sale (R. 87). By this statement the court gave a construction to the regulations which is in accord with the decisions in the circuit courts of appeal. *Commissioner* v. *Stevens,* 78 F. (2d) 713 (C. C. A. 2d); *Seeley* v. *Helvering, supra; Harriman National Bank* v. *Commissioner,* 43 F. (2d) 950 (C. C. A. 2d); *Hammitt* v. *Commissioner,* 79 F. (2d) 494 (C. C. A. 3d); *Commissioner* v. *Charavay,* 79 F. (2d) 406 (C. C. A. 3d); *Berks County Trust Co.* v. *Commissioner,* 78 F. (2d) 810 (C. C. A. 3d); *Wilson* v. *Commissioner, supra.*

Petitioners contend, however, as the first basis for granting writs of certiorari that the present case is in conflict with decisions in the Second and Third Circuit Courts of Appeals. *Commissioner* v. *Stevens,* 78 F. (2d) 713 (C. C. A. 2d); followed in *Fried* v. *Commissioner,* decided April 6, 1936, C. C. H., Vol. 4, 1936, par. 9222 (C. C. A. 2d); *Commissioner* v. *Charavay,* 79 F. (2d) 406 (C. C. A. 3d). They rely largely upon the statement by the lower court that, in its opinion, the cases were indistinguishable from the present one, and its refusal to reach the same result (R. 86). We submit while the lower court's judgment is correct, its opinion is in error in this regard, and that the facts in the *Stevens* and *Charavay* cases are quite different from those presented in the instant case.

The *Stevens* and *Charavay* cases were part of the same proceeding involving the brokerage firm of Stevens and Legg, and were considered by the Board of Tax Appeals *sub nom. Estate of Harry E. R. Hall,* 29 B. T. A. 1255. The Board's opinion in that case reveals that the firm of Stevens and Legg was a "specialist" on the New York Stock Exchange in some fourteen securities. As such, it held itself out as a dealer in those securities. At all times it carried a sufficient stock of them on hand to supply the demands of its customers, who numbered 101, and who made 268 separate purchases of its stocks during the taxable period. Its floor member occupied a regular post on the floor of the exchange, where he always stood ready to buy or sell. The firm's sales were large, and to meet the demands it kept on hand a large supply of the stocks which it constantly replenished through purchases.

This brief summary reveals the wide difference between the facts of that case and those of the present one. The purchases made by the Shafer firm were not to replenish a stock in trade, but were rather, as the Board found (R. 35), independent of the customers of the firm, and were made in expectation of a rise in the market price and for resale to anyone at a profit to the firms' account. The firm did not sell to and buy from brokers *as a merchant,* as did Stevens and Legg; it purchased and sold as a speculator. Moreover, in cases in-

volving facts quite similar to the present ones, both the Second and Third Circuit Courts of Appeal have recently denied the inventory privilege to speculators, with opinions which reveal their agreement with the principles laid down by the opinion in the instant case. *Seeley* v. *Helvering*, 77 F. (2d) 323 (C. C. A. 2d); *Hammitt* v. *Commissioner*, 79 F. (2d) 494 (C. C. A. 3d).

Petitioners allege, as a second ground for certiorari, that the question here presented is of great importance. However, there are only six cases involving this question now pending in the courts, five in the Circuit Courts of Appeals and one in a district court.[1] These appeals are pending in courts which have already passed on this question. An examination of the decisions in these cases and other Board decisions indicates that the Board has followed the regulations in requiring a showing that the taxpayer is regularly engaged as a merchant of securities in order to obtain the privilege of reporting on an inventory basis. See *Adirondack Securities Corp.* v. *Commissioner*, 23 B. T. A.

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[1] The cases on appeal are *Vaughan* v. *Commissioner*, 31 B. T. A. 548; *Brendle* v. *Commissioner*, 31 B. T. A. 1188; *Securities Allied Corp.* v. *Commissioner*, memorandum opinion rendered September 5, 1934; *Twining* v. *Commissioner*, 32 B. T. A. 600, all on appeal to the Circuit Court of Appeals for the Second Circuit; and *O'Neil* v. *Commissioner*, memorandum opinion rendered June 29, 1935, on appeal to the Court of Appeals for the District of Columbia. The other case is *The Leach Corp.* v. *Blacklidge*, pending in the United States District Court for Northern Illinois.

61; *Northeastern Surety Co.* v. *Commissioner*, 29 B. T. A. 297; *Oil Shares, Inc.*, v. *Commissioner*, 29 B. T. A. 664; *Hamill* v. *Commissioner*, 30 B. T. A. 955; *Lowell* v. *Commissioner*, 30 B. T. A. 1297. There seems to be no conflict as to the rule to be applied and the cases have depended largely on their individual facts.

CONCLUSION

We submit that the decisions on the question involved are not in conflict and that the instant cases do not present a question which warrants review by this Court. The petition should be denied.

Respectfully submitted.

STANLEY REED,
Solicitor General.
ROBERT H. JACKSON,
Assistant Attorney General.
SEWALL KEY,
LOUISE FOSTER,
Special Assistants to the Attorney General.

APRIL 1936.

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In the Supreme Court of the United States

OCTOBER TERM, 1936

No. 24

ALGERNON S. SCHAFER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 25

EDWARD SCHAFER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 26

LEONARD SCHAFER, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the United States Court of Appeals for the District of Columbia (R. 82–88)

is reported in 83 F. (2d) 317. The opinion of the Board of Tax Appeals is reported (R. 34–39) in 32 B. T. A. 289.

JURISDICTION

The judgments of the Court of Appeals were entered on March 2, 1936 (R. 88–90). The petition for writs of certiorari was filed April 6, 1936, and was granted on May 18, 1936. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether petitioners' firm was entitled under Section 22 (c) of the Revenue Act of 1928 to use inventories in determining gains or losses from its transactions in certain securities.

2. Whether the brokerage firm of Schafer Brothers was a dealer in securities within the meaning of Article 105 of Treasury Regulations 74 in the calendar year 1929.

3. Whether respondent is estopped retroactively to change a ruling of the Committee on Appeals and Review so as to deny petitioners' firm the use of inventories which it had under the former ruling.[1]

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[1] This question was not presented in the petition for certiorari, or in the specification of errors to be urged as set out therein. We believe, therefore, that it is not properly before the Court (see p. 20, *infra*). Nevertheless we discuss it on its merits.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra,* pp. 23–24.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 32–34) may, so far as material, be summarized as follows:

During the taxable year 1929, and for many years prior thereto, petitioners, under the firm name of Schafer Bros., conducted a general brokerage business with offices at 120 Broadway, New York City. The firm had been for many years a member of the New York Stock Exchange. Petitioner Leonard Schafer owned a seat on the Exchange, and was the floor member of the firm, and Algernon and Edward were the office members. Leonard was also a specialist in one or two stock issues. All three were active. (R. 32.)

Schafer Bros. was a dealer and merchant in securities on commission and on margin, and in that capacity executed orders for the purchase or sale of securities on any exchange where the particular securities were listed. From 1925 to 1929 the partnership also participated in a large number of syndicate and underwriting operations. (R. 33.)

As a part of its business activities, but with no relation to its customers' accounts or orders, the partnership has always, to some extent, bought and sold securities for its own account. Beginning in

1925 or 1926, however, and continuing through 1929, such trading became more extensive. It was conducted through orders executed by Leonard Schafer or other brokers, and had no relation to or connection with the accounts of the partnership's customers. The securities were purchased in expectation of a rise in the market price and for the purpose of resale to any buyer at a profit for the partnership's own account. They were not purchased for investment. (R. 33.)

Sales of these securities were made through orders given Leonard Schafer or other brokers, and the identity of the purchasers was not known. The purchases and sales were entered in the "Error Account" (the name having no significance). During 1929 entries in the Error Account showed purchases of 107,500 shares and sales of 92,500 shares of 72 different issues of securities. The number of such securities carried at the close of 1929 was unusually large, due to the change in the market and the consequent inability to sell at a profit. All but a comparatively few shares, however, were sold during 1930. (R. 33.)

In 1923 the New York Stock Exchange made a rule requiring its members to inventory securities for the purpose of certain Exchange questionnaires. Prior to 1925 this partnership had carried its own securities in the Error Account (as distinguished from those carried for customers' accounts) at cost, but beginning with that year and

including 1929, it inventoried them at their fair market value both at the beginning and end of the year. The change was made as a matter of business policy, but with knowledge of the effect of the taxing statutes. (R. 33–34.)

The Commissioner determined that the partnership was not a dealer in securities with respect to those carried in the Error Account, and that they must be carried at cost. Accordingly, he disallowed the use of inventories and increased the partnership's income by $511,667, the difference between the cost over the market value at the beginning and the end of the year. (R. 34.)

The Board of Tax Appeals concluded that as to this branch of the partnership's business it was a speculator and not a dealer in securities within the meaning of the regulations, and approved the deficiencies found by the Commissioner (R. 34–39). The Court of Appeals sustained the Board's decisions (R. 88–90).

SUMMARY OF ARGUMENT

I

The Revenue Acts are concerned primarily with realized gains and losses. The provision which allows the use of inventories in exceptional cases is not designed for the relief of the taxpayer; rather it is designed to authorize the Commissioner to require inventories where necessary correctly to reflect income. This is clearly shown by the legis-

lative history of the section. Consequently, the statute itself does not authorize petitioners to use inventories unless they are within the regulations of the Commissioner.

II

Nor is petitioners' firm a merchant or dealer in securities under the Regulations. The term "dealer", as used in Article 105, contemplates one who keeps a stock of securities on hand for sale to customers, buys to replenish that stock, has customers and relations with the general public. Petitioners' firm does not meet the prerequisites of Article 105, for the record reveals that it merely purchased securities from brokers for resale through brokers at a profit upon an expected rise in the market. The cases dealing with specialists, even if correctly decided, which is not admitted, do not support petitioners' contention, for specialists have functions and relationships with others that petitioners in the present case do not have.

III

Respondent is not now estopped from challenging the use of inventories by petitioners because of the prior practice of the Bureau or its expressed views on the subject. The factual basis for petitioners' argument is weak, but in any event the Commissioner may change his views. Reenactment of the statute without change since the ruling

is not material, for that is persuasive only if the rulings are Treasury Regulations or Treasury Decisions, which the ruling upon which petitioners rely is not.

ARGUMENT

I

PETITIONERS WERE NOT AUTHORIZED BY THE STATUTE TO USE INVENTORIES

The Revenue Acts are concerned primarily with realized gains and losses. *Weiss* v. *Wiener,* 279 U. S. 333, 335; *Lucas* v. *American Code Co.,* 280 U. S. 445, 449. Nevertheless, the Acts have consistently recognized that in certain types of business it is proper to make an exception to the general rule and to use inventories to determine annual gain or loss. See *Hamill* v. *Commissioner,* 30 B. T. A. 955, 958. Section 22 (c) of the Revenue Act of 1928 (*infra,* p. 23) accordingly provides that the taxpayer shall take inventories "Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer."

Petitioners' first point is that this statute itself, apart from the regulations promulgated under it, entitles them to the use of inventories, in accordance with the best accounting practice in the trade or business (Br. pp. 7–10). The legislative history of the inventory provision shows clearly, however, that the legislation was not designed for the relief

of taxpayers, but was intended as a grant of power to the Commissioner to require returns which would clearly reflect income.

The inventory provision had its origin in Section 203 of the Revenue Act of 1918 (c. 18, 40 Stat. 1057). The section appears in the Conference Print of the 1918 Revenue Bill with the Senate additions and deletions indicated by italics and stricken-through type as follows:

INVENTORIES

SEC. (22) ~~202~~ 203. That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may (23) ~~approve or~~ prescribe (24) *as conforming as nearly as may be to the best accounting practice in the trade or business and* as most clearly reflecting the income (25) ~~of the taxpayer~~

The elimination of the word "approve", contained in the House bill, indicates a studied avoidance of a grant of authority to the Commissioner to approve any basis which the taxpayer might choose. The obvious purpose of Congress was to limit the application of the section to cases where the Commissioner considered it necessary to require the use of inventories properly to reflect income. See H. Rept. 767, 65th Cong., 2d sess., p. 4; *Thomas Shoe*

Co. v. *Commissioner,* 1 B. T. A. 124; *Fried* v. *Commissioner,* 31 B. T. A. 638, 640, reversed, 83 F. (2d) 193 (C. C. A. 2d), pending on petition for writs of certiorari, Nos. 186 and 187, October Term, 1936.

II

PETITIONERS WERE NOT DEALERS OR MERCHANTS IN SECURITIES WITHIN THE MEANING OF ARTICLE 105 OF REGULATIONS 74

Petitioners' second contention is that even though the statute itself, apart from the regulations, does not allow them the use of inventories in respect of the transactions here in question, nevertheless they are, as to those transactions, within the purview of the term "dealer" as used in Regulations 74, Article 105 (*infra,* pp. 23–24). On the contrary, we believe that with respect to these transactions, entered into by the firm on its own account, petitioners were acting not as dealers or merchants but as speculators.

Under Section 22 (c) the Commissioner is vested with very broad discretion as to when inventories may be used. *Seeley* v. *Helvering,* 77 F. (2d) 323 (C. C. A. 2d). In the exercise of that discretion the Commissioner has announced by regulation that inventories are necessary in every business where the production, purchase, or sale of *merchandise* is an income-producing factor. Regulation 74, Article 101 (*infra,* p. 23). The difficulty of ascertaining the cost of goods sold in a manufacturing or merchandising business of any

magnitude is readily apparent, and there can be no doubt that the Commissioner's insistence upon inventories in such cases is proper. Hence there is no doubt that the regulations apply to any business in which merchandise is stocked and kept on hand for sale in the regular course of a manufacturing or merchandising business.

The term "merchandising" at once suggests numerous commercial activities, and the Government does not contend that its scope is confined within narrow limits. Without doubt, there are banks and commercial houses who purchase securities and keep them on hand for sale in a manner not unlike the stocks of merchandise maintained by the hardware merchant, the butcher, or the grocer. See *Harriman National Bank* v. *Commissioner,* 43 F. (2d) 950 (C. C. A. 2d). It was in recognition of this situation that the Commissioner promulgated Article 105 of Regulations 74, authorizing merchants in securities to make their returns upon the inventory basis. It was recognized that such a regulation might be open to abuse and that taxpayers who occupied no relationship to the general public requiring them to keep a stock of securities on hand would claim the privilege of being included in the category of merchants. Accordingly the regulation not only described the class of taxpayers who should use inventories but specifically excluded from its application certain taxpayers who might be thought to

fall within the definition but were in fact excepted therefrom. To this end Article 105 provides:

> Taxpayers who buy and sell or hold securities for investment or speculation and not in the course of an established business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule.

Securities are purchased by various classes of people with no other purpose than their future sale at a profit upon an expected or hoped for rise of the market. There would probably be no dissent from the statement that the term merchant does not apply to them. Such transactions are not those of a merchant, even if they constitute the exclusive business of an individual, a firm, or a corporation. *Adirondack Securities Corp.* v. *Commissioner,* 23 B. T. A. 61, 64; *Northeastern Surety Co.* v. *Commissioner,* 29 B. T. A. 297, 298, 299; *Donander Co.* v. *Commissioner,* 29 B. T. A. 312, 314; *Oil Shares, Inc.* v. *Commissioner,* 29 B. T. A. 664, 669, 670. *A fortiori,* they are not if they constitute merely a sideline. Such traders occupy no relationship to others which puts them in a class with the merchant. They have no customers to serve. No one expects them to have a stock of securities on hand to meet a demand that might be made upon them in the regular course of their business. They do not buy at wholesale and do not depend for their

profit upon the difference between wholesale and retail prices. For this they depend solely upon the fluctuations of the market. They are speculators or investors, not dealers or merchants.

We submit that an analysis of the facts relating to petitioners' business will disclose that with regard to the transactions here involved they were not dealers within the terms of the Regulations. The findings of the Board were (R. 33) that "as a part of its business activities, but with no relation to its customers' accounts nor to the execution of orders for its customers", the firm bought and sold securities for its own account, entering the transactions in a separate account called the "Error Account" (the name having no significance). The trading was conducted through orders executed by petitioner Leonard Schafer or other brokers, and the securities "were purchased in expectation of a rise in the market price and for the purpose of resale, to any buyer, at a profit for the partnership's own account." Sales of those securities were made through orders given Leonard Schafer or other brokers, and the identity of the purchasers was not known. These findings were expressly approved by the Court of Appeals (R. 85–86).

In Point II of their brief (p. 11) petitioners make a detailed analysis of Article 105 of the Regulations, which discloses certain prerequisites to classification as a dealer in securities, and assert (p. 12) that they have "complied with all the foregoing prerequisites." We submit that the find-

ings of the Board as outlined above do not support the assertion.

Adopting petitioners' analysis, the most important prerequisites to classification as a dealer are Nos. 4, 6, and 7, as follows:

> (4) * * * a dealer in securities is a merchant of securities, whether an individual, partnership or corporation * * *.
>
> (6) * * * regularly engaged in the purchase of securities and their resale to customers * * *.
>
> (7) * * * that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom * * *.

The Regulations, in other words, contemplate a purchase of securities as a stock in trade and replenishment from time to time with additional purchases in order to maintain a supply sufficient to meet the demands which might be expected from customers. This petitioners' firm did not do. There were no customers dependent upon petitioner for their source of supply. With respect to these securities petitioners occupied no relationship with the general public which justified or required them to prepare for and serve an anticipated demand. The transactions were wholly independent of the general brokerage business conducted by the firm, and were in no way designed to enable the firm to meet the demands of the customers with which it dealt in other aspects of its

business. There is no more reason for allowing petitioners a loss upon so much of these securities as they still held at the close of the taxable year than there is for allowing similar losses to every purchaser who found himself in possession of securities which had depreciated in value as a result of the 1929 debacle. Certainly, if the market had risen instead of having dropped there would have been no justification for taxing the vast army of speculators on unrealized gains. Similarly, there is, we submit, no occasion here to permit deductions upon unrealized losses.[2]

A brief comment should be made on some of the other prerequisities. The first is as follows:

> (1) * * * a description of the method employed shall be included in or attached to the return * * *.

It is conceded that this requirement has not been met (Br., p. 12). While it may be true that this requirement should not be fatal to a taxpayer's contention if all the other requirements have been met (see *Commissioner* v. *Stevens*, 78 F. (2d) 713 (C. C. A. 2d); *Vaughan* v. *Commissioner* (C. C. A. 2d), decided August 10, 1936, reported in Prentice

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[2] It is true that the Board found (R. 33) that "the partnership was a dealer and merchant of securities on commission and on margin." The exact nature of this business is not disclosed by the record. However, that phase of the firm's activity is not that which is involved in the present action, which concerns only the securities bought for the firm's account, and carried in its "Error Account."

Hall, Federal Tax Service (1936), Vol. 1, par. 1509, where, as here, there has been no substantial compliance with the regulation, the failure may well be fatal to petitioners' contentions.

The ninth requirement, as set forth by petitioners, states:

> (9) Taxpayers who buy and sell or hold securities for investment or speculation and not in the course of an established business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule.

Petitioners argue (Br. 20–21) from this language that if an established business is proved, the element of speculation becomes immaterial. That is, they interpret the sentence as if it read: "Taxpayers who buy and sell or hold securities for investment, or speculation not in the course of an established business, are not dealers." Even if we were to assume, *arguendo,* that such was the proper interpretation, petitioners would not benefit. Certainly, the regulation does not sanction the use of inventories in connection with speculation in securities merely because the taxpayer has some kind of an established business. The dealings in the Error Account here involved were found by both the Board and the court below to be wholly separate from the established business of petitioners' firm, that of a broker (R. 33, 83). In view of this express finding, petitioners' insistence that they

were an integral part of the business because they had been indulged in for many years (Br. 18–19) is not persuasive. Moreover, we do not believe that this sentence of Article 105 is to be interpreted in the manner suggested by the petitioners. To do so would be to make it inconsistent with the intent of all that precedes it. The sentence may be ineptly phrased, but we submit that it is simply intended to prevent any interpretation of the regulations which would include investors or speculators. See *Seeley* v. *Helvering,* 77 F. (2d) 323, 324 (C. C. A. 2d).

The contention that the partnership must be held to be a dealer and allowed to establish a loss by the inventory method, rather than by sale, because it might have been established had the stocks been sold (Br. 22, 24), is naive. It can hardly be claimed that a taxpayer must be allowed to take a loss without a sale because he is allowed to take a loss with a sale. Under a system of taxation which contemplates realized gains and realized losses, it cannot be admitted that the sale is superfluous.

Petitioners' contention (Br. 24) that the rules of the Stock Exchange, which require him to keep inventories for certain purposes, should control here requires little comment. In *Old Colony R. Co.* v. *Commissioner,* 284 U. S. 552, 562, and *Kansas City Southern Ry. Co.* v. *Commissioner,* 52 F. (2d) 372 (C. C. A. 8th), it has been held that not even the rules of a governmental agency, other than those of the Treasury, are controlling for tax

purposes. Furthermore, petitioners' method of handling a given transaction on their books can not, for income tax purposes, give them a status different from that assigned to them by law. *Brown* v. *Helvering,* 291 U. S. 193; *Spring City Co.* v. *Commissioner,* 292 U. S. 182, 189–190.

Petitioners have a heavy burden cast upon them to establish that the Commissioner's action in denying them the use of inventories was not only erroneous but plainly arbitrary. *Lucas* v. *Structural Steel Co.,* 281 U. S. 264; *Finance & Guaranty Co.* v. *Commissioner,* 50 F. (2d) 1061 (C. C. A. 4th); *Hamill* v. *Commissioner,* 30 B. T. A. 955. If it were otherwise, the court would be concerning itself merely with the relative merits of accounting, which, as this Court has said, is not within its province. *Brown* v. *Helvering,* 291 U. S. 193, 204–205. We submit that this burden has not been met merely by showing that the partnership engaged in transactions which, if engaged in by any other person, would be clearly classed as speculation; that is, by showing that it purchased the securities from brokers for resale through brokers at a profit upon an expected rise in the market.

Finally, petitioners rely heavily upon *Commissioner* v. *Stevens,* 78 F. (2d) 713 (C. C. A. 2d), and *Commissioner* v. *Charavay,* 79 F. (2d) 406 (C. C. A. 3d), in support of their contention. Both of these cases involved the transactions of the firm of Stevens & Legg, which dealt in securities as a floor "specialist" on the New York Stock Ex-

change. The Circuit Court of Appeals for the Second Circuit has recently denied the inventory privilege to a floor trader (*Seeley* v. *Helvering,* 77 F. (2d) 323), and the Circuit Court of Appeals for the Third Circuit to a broker who purchased stock for his own account on margin through other brokers (*Hammitt* v. *Commissioner,* 79 F. (2d) 494). While it is true that the functions of a specialist differ from the functions of a floor trader, or the activities of a broker dealing for his own account on margin, it is the Government's contention that the purchases and sales which the specialist makes for his own account in the securities in which he specializes partake of the nature of speculations no less than those of the taxpayers in the *Seeley* and *Hammitt* cases, *supra.* However, for the purposes of the instant case it will be necessary only to point out briefly that specialists have certain relationships with others which petitioners do not have, and hence that the *Stevens* and *Charavay* cases, even if correctly decided,[3] are not authority in petitioners' favor.[4]

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[3] On October 12, 1936, this Court granted the Government's petition for certiorari in a case involving the purchases and sales of a specialist for his own account of securities in which he specializes. *Commissioner* v. *Albert Fried*, Nos. 186 and 187, and assigned the case for argument with the present one. In our brief in that case the Government will present to the Court, in detail, the functions of a specialist which we believe prove that he, too, should be denied the inventory privilege.

[4] While the record discloses that its floor member, Leonard Schafer, was a specialist in two stocks (R. 32), it is en-

The functions of a specialist are two-fold. First, he is a broker's broker. As such he owns no securities, but merely executes orders which other brokers give him for the purchase and sale of the stock in which he specializes. Second, he is a purchaser and seller of the stock in which he specializes for his own account, such purchases and sales being made chiefly in order to create and maintain a close market.[5] The authorities appear further to agree that the purchases and sales of specialists for their own account of the securities in which they specialize resemble the purchases and sales of a floor trader—that is, that in respect thereof, each merely speculates for small profits.[6] Further, as

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tirely silent as to what these were. But it is clear from the findings that these purchases and sales were not made in connection with that phase of the brokerage business which the firm transacted through its floor member as a specialist. Though the petitioners did not question these findings below, they now assert, contrary thereto, as has already been pointed out, that these transactions were an "integral" part of the firm's business (Br. 7).

[5] See *Short-Selling* (1932 Edition), by James Edward Meeker, Economist of the New York Stock Exchange, pp. 32–33; *The Work of the Specialist*, by Dr. G. Wright Hoffmann, being Chapter XII of *The Security Markets—Twentieth Century Fund, Inc.* (1935), p. 407; *Stock Market Theory and Practice* (1932 Edition) by R. W. Schumaker, Financial Editor of Forbes Magazine, p. 34, and the Report of the Securities and Exchange Commission on the Feasibility and Advisability of the Complete Segregation of the Functions of Dealer and Broker, made on June 20, 1936, pursuant to Section 11 (c) of the Securities Exchange Act of 1934, p. 25 *et seq.*

[6] See, for example, *The Work of the New York Stock Exchange* (1930 Edition) Meeker, pp. 83, 211; *The Stock*

pointed out in the Report on the Feasibility and Admissibility of the Complete Segregation of the Functions of Dealer and Broker, issued by the Securities and Exchange Commission in 1936, pages 33–34, the purchases and sales of the specialist may be expected to be of an in-and-out character which tend to balance each other over brief periods, because under ordinary circumstances he is willing to trade either as a buyer or as a seller. Without conceding that specialists are entitled to use inventories, we submit that enough has been said to justify the conclusion that petitioners are not aided by the *Stevens* and *Charavay* cases.

III

THE PRIOR PRACTICE OF THE BUREAU DOES NOT FORECLOSE A DECISION ON THE MERITS

Petitioners contend, in Point III of their brief, that the Bureau practice of prior years, and expressed views on the subject, estop the Commissioner from using any other than the inventory basis. The point was not raised by the petition for certiorari, or by any of the specifications of errors to be urged set out therein, and it is, therefore, not appropriately urged now. *Helvering* v. *Taylor,* 293 U. S. 507, 511; *Gunning* v. *Cooley,* 281 U. S. 90, 98; *Warner Co.* v. *Pier Co.,* 278 U. S. 85, 91. In any event, the point is without merit.

Exchange from Within (1913 Edition), by William Clark Van Antwerp, p. 279; *The Stock Market* (Revised Edition, 1934), by Dr. S. S. Huebner, p. 177.

It is asserted generally that the Bureau approved petitioners' method of reporting in prior years (Br. 25–26). There is no proof of the basis upon which the Bureau acted, or that it had full knowledge of the facts. The one partnership tax return in evidence fails to disclose any information, either as required by the regulations or in answer to specific questions which would reveal the present method. There is no showing that the Commissioner's agents were ever informed of the method, and none as to what representations may have been made to them. Indeed, the record does not furnish an adequate basis for the conclusion that the Commissioner has ever approved the use of inventories for calculating gains and losses upon transactions made by petitioners for their own account. The most that can be claimed is that petitioners have heretofore reported some transactions on an inventory basis which have not been questioned.

But whatever the situation may have been in earlier years, it is now settled that the Commissioner has ample authority to revise an earlier ruling or to decide a question in a later year differently from the way he decided it in an earlier year. *Burnet* v. *Henry,* 283 U. S. 229; *John M. Parker Co.* v. *Commissioner,* 49 F. (2d) 254 (C. C. A. 5th); *Sweets Co. of America* v. *Commissioner,* 40 F. (2d) 436 (C. C. A. 2d); *Laher Auto Spring Co.* v. *United States,* 5 F. Supp. 38 (C. Cls.). Furthermore, the ruling relied on by petitioners is not such as

calls for the invocation of the rule that repeated reenactments of the statute without change warrant the conclusion that Congress has accepted an interpretation given it by the Treasury Department. That rule is applicable only to Treasury Regulations and Treasury Decisions which are formally promulgated by the Commissioner with the approval of the Secretary. *Helvering* v. *New York Trust Co.*, 292 U. S. 455, 467–468.

We submit that the Court of Appeals correctly held (R. 87) that if there was in fact any neglect of the Commissioner in the premises, it can not bind the Government to its prejudice. A similar argument was aptly characterized by the Circuit Court of Appeals for the Second Circuit as makeweight. *Seeley* v. *Helvering*, 77 F. (2d) 323, 324.

CONCLUSION

It is therefore respectfully submitted that the decisions of the court below should be affirmed.

STANLEY REED,
Solicitor General.
ROBERT H. JACKSON,
Assistant Attorney General.
SEWALL KEY,
CARLTON FOX,
Special Assistants to the Attorney General.
CHARLES A. HORSKY,
Attorney.

OCTOBER 1936.

APPENDIX

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 22. GROSS INCOME.

* * * * *

(c) *Inventories.*—Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

Treasury Regulations 74:

ART. 101. *Need of Inventories.*—In order to reflect the net income correctly, inventories at the beginning and end of each year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor. * * *

ART. 105. *Inventories by dealers in securities.*—A dealer in securities, who in his books of account regularly inventories unsold securities on hand either—

(a) At cost;

(b) At cost or market, whichever is lower; or

(c) At market value,

may make his return upon the basis upon which his accounts are kept; provided that

a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the Commissioner. For the purpose of this rule a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation and not in the course of an established business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule.

U. S. GOVERNMENT PRINTING OFFICE: 1939

Louis S. Tim and Adelina T. Schafer, Executors of the estate of

SUPREME COURT OF THE UNITED STATES.

Nos. 24, 25, 26.—October Term, 1936.

Algernon S. Schafer, Petitioner, 24 *vs.* Guy T. Helvering, Commissioner of Internal Revenue. Edward Schafer, Petitioner, 25 *vs.* Guy T. Helvering, Commissioner of Internal Revenue. Leonard Schafer, Petitioner, 26 *vs.* Guy T. Helvering, Commissioner of Internal Revenue.	On Writs of Certiorari to the United States Court of Appeals for the District of Columbia.

[December 7, 1936.]

Mr. Justice McReynolds delivered the opinion of the Court.

Petitioners in these three causes were partners in Schafer Brothers, brokers at 120 Broadway, and member of the New York Stock Exchange. The firm traded for others; also bought and sold securities for itself. The latter were carried on its books in the so-called "Error Account".

In order to ascertain the partners' taxable profits during 1929 the Commissioner held that securities in that account should be valued at their cost price; that as to them the partnership was not a dealer permitted to use inventories under Article 105, Treasury Regulations 74. Accordingly he found material deficiencies against each of the petitioners. The Board of Tax Appeals sustained his action; the court below affirmed.

The petition, upon which we granted the writs, states this as the "question presented": "Was the partnership of which these petitioners were members a 'dealer in securities' as to securities bought and sold for its own account, and as such entitled to inventory such securities at cost or market, whichever was lower, in com-

puting its income for 1929? . . . Determination of the amount thus to be included in the income of each petitioner depends upon the basis upon which the partnership income is computed."

And as "reasons for granting the writs" it averred: "(1) The decision of the Court of Appeals of the District of Columbia is in irreconcilable conflict on a matter of statutory interpretation with the decision of the Court of Appeals for the Second Circuit in *Commissioner* v. *Stevens*, 78 F. (2d) 713, and with the decision of the Court of Appeals for the Third Circuit in *Commissioner* v. *Charavay*, 79 F. (2d) 406. (2) The precise question of statutory construction here presented is one of general public importance which has never been settled, and should be determined by this Court because of the number of pending cases involving the question, as well as the frequent occasions that the question is bound to arise in the future."

Our consideration is confined to the issue so tendered by the petition.

Commissioner v. *Stevens* and *Commissioner* v. *Charavay, supra,* turned on the question whether Stevens and Legg, a "Specialist" on the New York Stock Exchange, was a dealer whose profits should be determined upon inventories under Article 105, Treasury Regulations 74. The Board of Tax Appeals held it was, and the Circuit Court of Appeals in both the Second and Third Circuits approved that view. Considering the differing circumstances, we find no real conflict between the holdings in those cases and the ruling below. See *Vaughan* v. *Commissioner*, 85 F. (2d) 497.

Pertinent provisions, Revenue Act of 1928, c. 852, 45 Stat. 791, and Treasury Regulations 74, are in the margin.*

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*Revenue Act of 1928, c. 852, 45 Stat. 791:

"Sec. 22. GROSS INCOME.

" . . .

"(c) *Inventories.*—Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income."

Treasury Regulations 74:

"Art. 101. *Need of Inventories.*—In order to reflect the net income correctly, inventories at the beginning and end of each year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor. . . .

"Art. 105. *Inventories by dealers in securities.*—A dealer in securities,

Schafer Brothers was not a "Specialist" in the stocks entered in its "Error Account". The Board of Tax Appeals found: "The stocks in dispute were purchased for the firm's own account solely in expectation of a rise in the market, for sale to anyone at a profit, 'as distinguished from a purchase to create a stock of securities to take care of future buying orders in excess of selling orders.'" "They were purchased solely in expectation of a rise in the market, for the partnership's own account for resale, to any buyer, at a profit. The meaning of 'dealer in securities,' as defined in the controlling regulation, has been considered many times by the courts, and this Board. It is limited to one who, as a merchant, buys and sells securities to customers for the profit thereon."

The evidence adequately supports these findings.

Seeley v. *Commissioner*, 77 F. (2d) 323, *Hammitt* v. *Commissioner*, 79 F. (2d) 494, and *Vaughan* v. *Commissioner*, *supra*, are in harmony with our conclusion.

We find no adequate reason for disturbing the challenged judgment, and it is affirmed.

Affirmed.

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who in his books of account regularly inventories unsold securities on hand either—

(a) At cost;
(b) At cost or market, whichever is lower; or
(c) At market value,

may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the Commissioner. For the purpose of this rule a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation and not in the course of an established business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule."